Supreme Court, U.S.
FILED

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No.

In The

Supreme Court of the United States

October Term, 1997

BARRY K. SCHWARTZ PARTNERSHIP, ZENYA YOSHIDA, EARL H. SHULTZ and KENNETH FRANZHEIM II,

Petitioners,

vs.

ROGER SULLIVAN,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Is there a rational basis for the Ninth Circuit's direction to the trial court to assess attorney's fees against petitioners under § 11(e) of the Securities Act of 1933, 15 U.S.C. § 77k(e), on the ground that petitioners' claims "bordered on the frivolous," where the same circuit court has expressly upheld the trial court's determination that none of petitioners' claims was "frivolous?"

2. Should there be a uniform standard in the Federal courts of the United States for awards of attorney's fees under § 11(e) of the 1933 Act?

LIST OF PARTIES

The parties to the proceedings below were the petitioners Barry K. Schwartz Partnership, a New York General Partnership of Barry K. Schwartz and Calvin Klein; Zenya Yoshida, now deceased; Earl H. Shultz; Kenneth Franzheim II; non-petitioning plaintiffs Robert D. Stratmore and Richard D. Schultz; and respondent Roger Sullivan, executor of the estate of Frank L. Bryant.[1]

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1. The decision of the court below also dealt with other issues unrelated to petitioners. The parties to those appeals were plaintiffs Richard D. Schultz and Blas R. Casares; Sullivan; and defendants Bateman Eichler, Hill Richards, Inc.; and Charles R. Hembree and Kincaid, Wilson, Schaeffer & Hembree, P.S.C. *See* Appendix A.

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Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit entered in the above proceedings on May 14, 1997.

OPINIONS BELOW

The opinion of the court of appeals dated May 14, 1997 is unreported and is printed in Appendix A, p. 1a. That court's August 1, 1997 order denying rehearing is reprinted in Appendix G, p. 74a.

The trial court's decision dated December 22, 1988 dismissing petitioners' claims against Frank L. Bryant and others is unreported and is printed in Appendix F, p. 51a. (No appeal was taken from the portions of that decision that dismissed the section 12 claims against Bryant.) Excerpts from the hearing transcript where the trial court orally denied attorney's fees to Frank L. Bryant on August 17, 1989 are printed in Appendix E, p. 46a. A previous decision of the court of appeals remanding the trial court's 1989 denial of attorney's fees under § 11(e) (*Layman v. Combs*, 994 F.2d 1344 (9th Cir. 1992), *cert. denied sub nom., Bryant v. Klein*, 510 U.S. 914 (1993)) is printed in Appendix D, p. 18a. Excerpts from the hearing transcript of the trial court's second oral denial of fees on June 14, 1994 and its written order denying fees against petitioners on July 1, 1994 (following the remand ordered in *Layman v. Combs, supra*) are printed in Appendix B, p. 13a and Appendix C, p. 16a, respectively.[2]

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2. Other reported opinions involving the same cases are *Schultz v. Hembree*, 975 F.2d 572 (9th Cir. 1992), *cert. dismissed, Casares v. Spendthrift Farm*, 506 U.S. 948 (1992); *McGonigle v. Combs*, 968 F.2d 810 (9th Cir. 1992); and *Stratmore v. Combs*, 723 F. Supp. 458 (N.D. Cal. 1989). This Court also dealt with a case involving the Spendthrift Farm public offering in *Plaut v. Spendthrift Farm*, 514 U.S. 211 (1995).

STATEMENT OF JURISDICTION

The judgment of the court of appeals was entered on May 14, 1997. Appx. A, p. 1a. Petitioners' timely motion for rehearing was denied on August 1, 1997. Appx. G, 74a-75a. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

This case involves Sections 11(e) and 12 of the Securities Act of 1933. 15 U.S.C. §§ 77k(e) & 77*l*. Section 11(e) provides in relevant part:

> In any suit under this or any other section of this subchapter the court may, in its discretion, require an undertaking for the payment of the costs of such suit, including reasonable attorney's fees, and if judgment shall be rendered against a party litigant, upon the motion of the other party litigant, such costs may be assessed in favor of such party litigant (whether or not such undertaking has been required) if the court believes the suit or the defense to have been without merit, in an amount sufficient to reimburse him for the reasonable expenses incurred by him, in connection with such suit, such costs to be taxed in the manner usually provided for taxing of costs in the court in which the suit was heard.

The text of Section 12 in effect during the pendency of petitioners' claims is set forth in Appendix H, p. 76a.

STATEMENT OF THE CASE

A. Summary Statement

In August 1983, petitioners were among those who invested in a private placement of stock of Spendthrift Farm, Inc., a thoroughbred horse farm in Lexington, Kentucky. When the stock value fell precipitously, petitioners were among 15 plaintiffs in nine consolidated actions and alleged, *inter alia*, violations of § 12 of the Securities Act of 1933, 15 U.S.C. § 77*l*. One of the named defendants was Frank L. Bryant, now deceased and represented by his executor Roger Sullivan. In December 1988, after this Court's decision in *Pinter v. Dahl*, 486 U.S. 622 (1988), the district court dismissed all of plaintiffs' claims against certain defendants, including Bryant. *See* Appendix F. The remaining defendants ultimately prevailed on all the claims against them.

Bryant, among others, then sought attorney's fees from the plaintiffs on various theories, including § 11(e) of the 1933 Act. In 1989, the district court denied Bryant's motion for fees under § 11(e), finding that none of plaintiffs' claims against Bryant under the 1933 Act was frivolous. Appx. E, p. 47a, *see also Layman v. Combs, supra*, 994 F.2d at 1353, Appx. D, p. 30a. On appeal, the Ninth Circuit expressly held that the trial court had **not** abused its discretion in finding that none of the plaintiffs' claims against Bryant was frivolous. Appx. D, p. 31a, n. 7. The court of appeals held, however, that in the Ninth Circuit the "without merit" standard for an assessment of fees under § 11(e) is not whether the claims are "frivolous" but whether they "border on the frivolous," and remanded to the trial court to determine if plaintiffs' '33 Act claims "bordered on the frivolous." Appx. D, p. 30a.

Following remand, the trial court again declined to assess

attorney's fees against plaintiffs under § 11(e), finding that the claims did not "border on the frivolous" and that the trial judge had discretion to deny fees in any event. Appx. B, p. 15a; Appx. C, p. 17a. Bryant appealed again, limiting this appeal to just the petitioners and two other plaintiffs, who had not been among the potential investors to whom Bryant had directly promoted the stock. On this appeal, a different panel of the Ninth Circuit again reversed, this time holding that petitioners' § 12 claims "bordered on the frivolous," because Bryant had not spoken to petitioners and because he had not personally drafted any of the offering materials, and ordered the trial court to assess fees against petitioners. *Layman v. Bryant*, Appx. A, pp. 6a-7a. The court of appeals did not disturb its prior holding that the trial court had not abused its discretion in concluding that none of petitioners' '33 Act claims was frivolous.

B. The Context of the Issues for Review

The key issue on petitioners' § 12 claims against Bryant was whether Bryant could be found to be a "seller" of securities within the meaning of that section in the private placement in which petitioners bought their stock. Petitioners' complaints had been filed two years before this Court decided *Pinter v. Dahl*, 486 U.S. 622 (1988), which clarified the meaning of "seller" under § 12(1) of the 1933 Act. *Pinter* defines "seller" as one who "successfully solicits the purchase, motivated at least in part by a desire to serve his own financial interests or those of the securities owner." 486 U.S. at 647.

Prior to *Pinter*, courts had not defined uniformly the term "seller." 486 U.S. at 642. Whether Bryant could be a seller under the pre-*Pinter* law depended on whether he was a "substantial participant," a concept that at the time was "without precise bounds." *S.E.C. v. Rogers*, 790 F.2d 1450, 1456 (9th Cir. 1986). It was a concept, however, that did not require communications with each individual investor.

For example, in *S.E.C. v. Seaboard Corp.*, 677 F.2d 1289, 1295, n. 4 (9th Cir. 1982), the Ninth Circuit pointed out that some courts read § 12 to impose liability on aiders and abettors. In that case, summary judgment in favor of one Jones, an attorney, was reversed where Jones had rendered an opinion regarding removal of a restrictive legend on a debenture which was later converted to stock for immediate resale, and attended meetings with the selling companies' principals where there were discussions of the likelihood that the stock was restricted. *Id.* at 1292-93. The court held that there were issues of fact as to "the extent of [Jones's] participation in the transaction as a whole," even though Jones had no direct dealing with the purchaser and drafted no offering documents. *Id.* at 1295.

In *S.E.C. v. Holschuh*, 694 F.2d 130 (7th Cir. 1982), Holschuh was held to be a "substantial participant" in a securities sale notwithstanding that he had had no contact with investors and had not drafted offering materials. The court noted that certain of the information in the offering circular was traceable to Holschuh's conversations with the writers. *Id.* at 134. Holschuh was a necessary participant because

> Holschuh's actions, far from being unwitting or *de minimis*, had intimately involved him in the details of numerous stages of a greater plan, of which he had in fact been a designer, and which he knew was calculated toward a hurried issuance of new securities.

Id. at 140.

In *Koehler v. Pulvers*, 614 F. Supp. 829 (S.D. Cal. 1985), an attorney who was on notice of serious problems with an offering and prepared offering materials was held a "seller" under the "participant" test. The court pointed out:

> In short, because Mr. Cheyne lent his name and provided necessary and substantial services to promote and facilitate the sale of securities which he should have known issued in violation of registration and disclosure requirements, he proximately caused the investors' injuries.

Id. at 845.

Aider and abettor liability was also a viable pre-*Pinter* theory under § 12, if a defendant's scienter could be shown. *In re Gas Reclamation, Inc., Securities Litigation*, 659 F. Supp. 493, 509 (S.D.N.Y. 1987).

Before the private placement in the instant case, Spendthrift was 100% owned by its founder Leslie Combs and his son Brownell. ER 277.[3] Within four months of the private placement, Spendthrift completed an initial public offering of its stock. Though Bryant had been hired by Spendthrift as a financial consultant in connection with the public offering, he had deliberately interjected himself into the private placement.

Bryant understood that the private placement was an "integral part of the financial plan" for Spendthrift. ER 3660, 3671. A successful private placement giving Spendthrift a roster of wealthy horsemen as investors was viewed as helping make the public offering more attractive. ER 487-89, 3659. The forthcoming public offering was likewise to be an inducement to potential private placement investors for whom the public offering would provide a market for any stock purchased. ER 290, 411-12.

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3. The reference is to the Excerpt of Record filed in the Ninth Circuit pursuant to Ninth Circuit Rule 30-1.

Bryant's activities included the following:

- To "expedite the public offering," Bryant obtained authority from the Spendthrift owners to have a legal review of the private placement by the same lawyers that would be involved in the public offering. ER 3676.

- Bryant hired and directed the lawyers. ER 3718, 3760.

- Bryant met with the lawyers and investment bankers and considered with them whether the private placement complied with the securities laws. ER 3774-82.[4]

- Bryant himself contacted potential investors (including plaintiffs in *Layman v. Combs*, but not these particular petitioners) to promote the private placement of Spendthrift stock. ER Supp. 27, 47; CR 949.[5] Bryant told at least one potential investor that he had "made an investment" in Spendthrift and that he thought it was an "extremely good, fine deal." ER Supp. 27, 47. Bryant did not disclose that he had a "put" arrangement through Brownell Combs which provided the $500,000 for his "investment" in Spendthrift on a risk-free basis. ER 3695-99; ER Supp. 27; CR 949.

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4. Among the topics discussed were the possibility that the private offering would be treated as integrated with the forthcoming public offering, which would require registration of the private placement stock; adequacy of disclosures in the private placement offering materials; failure to achieve "blue sky compliance" (ER 3781) in the private placement; and an undisclosed "salary (or fee) arrangement" (*id.*) with the private placement's principal promoter. ER 3774-82.

5. The reference is to the Clerk's Record in *Layman v. Combs*, N.D. Cal. Case No. C-86-1692-CAL.

- Bryant directed that the lawyers "review and approve" the private placement arrangements before the $35 million private placement closed. ER 3718.

- Bryant personally undertook to investigate and report on a Spendthrift executive who had been arrested on drug charges. ER 3717-19. Bryant's report was reflected in a supplemental disclosure to the private placement investors. ER 409.

In late July of 1983, the lawyers concluded that it was prudent to postpone the private placement to give them time to determine if there were additional disclosures that should be made to the private investors. ER 3784. The Combses refused to postpone the closing. *Id.* Bryant was kept fully aware of these developments and of the lawyers' inability or refusal to "approve" the private placement. ER 3764-65, 3784-86, 3796.

Though not "approving" the private placement, the lawyers drafted supplemental disclosures. ER 3784-86, 3795. But the supplemental disclosures left various facts undisclosed, including a $5 million commission to the principal promoter, Spendthrift's true financial condition, the basis of the accounting method used in lieu of generally accepted accounting principles and that Bryant was not, in fact, an investor at risk in the private offering. ER 407-12, 3785. Bryant and the other professionals acquiesced in the closing of the private placement in these circumstances. ER 3784-86, 3796.

REASONS FOR GRANTING THE WRIT

There are two compelling reasons for this Court to review this case. First, there is disorder among the circuits on the standards of § 11(e). The statute allows for attorney's fees if a claim is "without merit." The Ninth Circuit construes this to

mean "bordering on frivolous" but provides no guidance as to its meaning besides the suggestion that it is something less than frivolous. Some other circuits purport to use a "frivolous" standard; some apply the "without merit" language. This Court's guidance is needed to give coherent definition to the statutory standard.

Second, the Ninth Circuit's decision is a clear example of the incoherence of the "bordering on frivolous" standard. The court of appeals equated petitioners' inability to prove that Bryant was a "seller" for § 12 purposes with a conclusion that petitioners' claims "bordered on frivolous." Since the court of appeals' 1992 decision expressly upheld the district court's finding that petitioners' claims were not frivolous (*Layman v. Combs*, *supra*, 994 F.2d at 1353, n. 7, Appx. D, p. 31a, n. 7), the court necessarily based its decision on a perceived difference between frivolity and its border, a difference that has no rational basis and cannot be explained.

I.

THE CIRCUIT COURTS ARE NOT APPLYING A CONSISTENT STANDARD FOR FEE AWARDS UNDER SECTION 11(e) OF THE 1933 ACT.

The Ninth Circuit stands with the Sixth and Tenth Circuits in using the language of "bordering on frivolous" to describe the "without merit" standard of § 11(e).[6] The Fifth and Eighth

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6. *Western Federal Corp. v. Erickson*, 739 F.2d 1439, 1444 (9th Cir. 1984) (affirming an assessment of fees); *Weil v. Investment/Indicators Research & Management Co., Inc.*, 647 F.2d 18, 22 (9th Cir. 1981) (reversing an order requiring an undertaking); *Can-Am Petroleum v. Beck*, 331 F.2d 371, 374 (10th Cir. 1964) (reversing an assessment of fees); *Shaw v. Merritt-Chapman & Scott Corp.*, 554 F.2d 786, 788 (6th Cir.) (affirming an assessment of fees), *cert. denied*, 434 U.S. 852 (1977).

Circuits express the standard in terms of "frivolous."[7] Different panels of the Second Circuit have used both standards.[8] The other circuits have either not addressed the issue or apply the "without merit" language of the statute without recharacterizing in terms of proximity to frivolity. Petitioners emphasize that no decision we have found purports to be able to differentiate claims that are "frivolous" from claims that merely "border on the frivolous." The Ninth Circuit holdings in this case that none of plaintiffs' claims was frivolous, yet ordering that fees be assessed because the claims "bordered on the frivolous," is without precedent.[9]

The underlying case is a good example of why the Court should establish a uniform standard. Numerous cases from around the country based on the private placement of Spendthrift stock were consolidated in the Northern District of California, including cases originally filed in the Sixth and Eleventh Circuits. This is not at all uncommon in securities litigation.

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7. *Johnson v. Yerger*, 612 F.2d 953, 959-960 (5th Cir. 1980) (affirming a denial of fees); *Junker v. Crory*, 650 F.2d 1349, 1364-1365 (5th Cir. 1981) (reversing an assessment of fees); *Rucker v. La-Co, Inc.*, 496 F.2d 850, 853 (8th Cir. 1974) (affirming an assessment of fees).

8. Second Circuit cases using the bordering on frivolous standard are *Katz v. Amos Treat & Co.*, 411 F.2d 1046, 1056 (2d Cir. 1969) (affirming a denial of fees); *Klein v. Shields & Co.*, 470 F.2d 1344, 1347-48 (2d Cir. 1972) (reversing an assessment of fees); and *Aid Auto Stores Inc. v. Cannon*, 525 F.2d 468, 471-472 (2d Cir. 1975) (reversing an assessment of fees). In *Zissu v. Bear, Stearns & Co.*, 805 F.2d 75, 80 (2d Cir. 1986), the court used the frivolous standard in affirming an assessment of fees.

9. Courts generally, including the courts of appeals referred to above, will assess fees under § 11(e) if a claim or defense is in "bad faith." There was no finding at any stage of this case that petitioners' claims were in bad faith.

Use of inconsistent standards in applying § 11(e) could lead to a party's exposure to sanction under § 11(e) for having filed a case being dependent on the circuit to which his case is transferred. As it is, the Ninth Circuit's decisions as to "frivolous" and "bordering on frivolous" in this case are as a practical matter irreconcilable.

II.

THERE IS NO RATIONAL BASIS FOR ASSESSING ATTORNEY'S FEES FOR DEFENDING AGAINST CLAIMS EXPRESSLY FOUND NOT FRIVOLOUS BECAUSE OF A STANDARD ALLOWING ASSESSMENT OF FEES WHERE CLAIMS "BORDER" ON THE FRIVOLOUS.

The standard set forth in § 11(e) is "without merit." The leading appellate case cited as precedent for the "bordering on frivolous" standard is *Can-Am Petroleum Co. v. Beck*, 331 F.2d 371, 374 (10th Cir. 1964). There, the court reversed an assessment of fees against a defendant on the ground that the district court had made no finding that the defense was "without merit." *Id.* The court of appeals remanded for a specific finding on the point, "[s]ince an unsuccessful defense is not necessarily without merit and, indeed, the term implies a defense bordering on frivolity." *Id.* Manifestly, that decision does not suggest that there is a means of differentiating between frivolous claims and claims bordering on frivolous.

In *Katz v. Amos Treat & Co.*, 411 F.2d 1046 (2d Cir. 1969), Judge Friendly quoted the "bordering on" language, though questioning the standard:

> We think we can distinguish between cases that are frivolous and others that are simply unmeritorious, but

> we confess considerable lack of confidence in our ability to apply the test of "bordering on" frivolity.

411 F.2d at 1056. The Second Circuit in *Katz* affirmed a denial of fees and had no occasion to attempt to distinguish a frivolous claim from one bordering on frivolous. Nor did the Second Circuit suggest that any such distinction could be drawn. Petitioners respectfully submit that there is no rational distinction that can be articulated and that the Ninth Circuit's ruling that fees can be assessed on the basis of such a distinction is arbitrary.

This Court can and should define "without merit" for the Federal court system, whether the standard should be the equivalent of what is required under Rule 11, Federal Rules of Civil Procedure[10], or under a different rule.

Given that an unsuccessful claim is not necessarily "without merit," (*Can-Am Petroleum Co. v. Beck*, 331 F.2d 371, 374 (10th Cir. 1964)), an understandable guideline is essential. Nine years after the merits of petitioners' § 12 claims were decided, the Ninth Circuit discovered that those claims bordered on frivolous. Much of the length of this legal odyssey is due to the impossibility of applying a rational meaning to "bordering on frivolous." The consequences of a fee assessment in multi-district securities litigation can be horrendous.[11] Parties, the Bar and the court system should have a clear definition of the

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10. The Rule 11 standard for avoiding sanctions is "[T]he claims . . . are warranted by existing law or by non-frivolous argument for the extension, modification or reversal of existing law or the establishment of new law." Fed. R. Civ. Proc. 11(b)(2).

11. At another stage of this proceeding, *not* before the Court on this petition, fees of $4.1 million were assessed against two of the plaintiffs under an application of state fee-shifting statutes. Appx. A, p. 7a.

standard for assessing fees. A clear definition in this case would have prevented almost a decade of wrangling over fees.

CONCLUSION

For the foregoing reasons, petitioners respectfully submit that this Court should grant a writ of certiorari to the United States Court of Appeals for the Ninth Circuit.

Respectfully submitted,

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APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT IN THE MATTER OF *LAYMAN v. BRYANT* FILED MAY 14, 1997

GEORGE LAYMAN,

Plaintiff,

and

CALVIN KLEIN; BARRY K. SCHWARTZ, d/b/a BARRY K. SCHWARTZ PARTNERSHIP, a New York general partnership; EARL H. SHULTZ; KENNETH FRANZHEIM, II,

Plaintiffs-Appellees,

v.

FRANK L. BRYANT,

Defendant-Appellant.

RICHARD D. SCHULTZ,

Plaintiff-Appellant,

v.

BATEMAN EICHLER, HILL RICHARDS, INC.; CHARLES R. HEMBREE; KINCAID, WILSON, SCHAEFFER & HEMBREE,

Defendants-Appellees.

RICHARD D. SCHULTZ,

Plaintiff-Appellant,

v.

Appendix A

BATEMAN EICHLER, HILL RICHARDS, INC.; CHARLES R. HEMBREE; KINCAID, WILSON, SCHAEFFER & HEMBREE,

Defendants-Appellees.

RICHARD D. SCHULTZ,

Plaintiff-Appellant,

v.

ROGER SULLIVAN,

Defendant-Appellee.

BLAS R. CASARES,

Plaintiff-Appellant,

v.

CHARLES R. HEMBREE; KINCAID, WILSON, SCHAEFFER & HEMBREE*; KEMPER SECURITIES; ROGER SULLIVAN,

Defendants-Appellees.

BARRY K. SCHWARTZ, d/b/a BARRY K. SCHWARTZ PARTNERSHIP, a New York general partnership; CALVIN KLEIN; ZENYA YOSHIDA; KAZUKO YOSHIDA; ROBERT D. STRATMORE; KATSUMI YOSHIDA; EARL H. SHULTZ; TERUYA YOSHIDA; KENNETH FRANZHEIM, II; HARUYA YOSHIDA,

Plaintiffs-Appellees,

and

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* Judgment Acquisition Corporation was substituted for Charles R. Hembree and Kincaid, Wilson, Schaeffer & Hembree.

Appendix A

GEORGE E. LAYMAN,

Plaintiff,

v.

FRANK L. BRYANT,

Defendant-Appellant.

No. 94-16391, No. 94-17067, No. 94-17070, No. 95-15343, No. 95-15344, No. 97-15340

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

1997 U.S. App. LEXIS 11446

July 9, 1996, Argued; March 7, 1997, Submitted,
San Francisco, California
May 14, 1997, FILED

* * *

PRIOR HISTORY: Appeals from the United States District Court for the Northern District of California. D.C. No. CV-86-01692-CAL, D.C. No. CV-88-03175, D.C. No. CV-87-06038-CAL, D.C. No. CV-87-06038-CAL, D.C. No. CV-87-01129-CAL, D.C. No. CV-86-01692-CAL. Charles A. Legge, District Judge, Presiding.

DISPOSITION: Affirmed in part, reversed in part, and remanded.

JUDGES: Before: CHOY, O'SCANNLAIN and LEAVY, Circuit Judges.

Appendix A

OPINION: MEMORANDUM**

Defendant-appellant Roger L. Sullivan, executor of the estate of Frank L. Bryant (collectively "Bryant"), appeals from the district court's denial of his request for attorneys' fees pursuant to § 11(e) of the 1933 Securities Act, 15 U.S.C. § 77k(e). Plaintiffs-appellants Blas Casares and Richard D. Schultz appeal from the district court's grant of attorneys' fees in favor of defendants-appellees Bryant, Kemper Securities, Inc. ("Kemper"), Charles R. Hembree, and Kincaid, Wilson Schaeffer & Hembree, P.C.S. ("Kincaid"), pursuant to Florida and Ohio fee shifting statutes. We affirm in part, reverse in part, and remand.

I. Bryant's appeal.

Bryant appeals the denial of § 11(e) attorneys' fees from those plaintiffs who never communicated with him before investing, i.e. Calvin Klein and his partner Barry K. Schwartz d.b.a. Barry K. Schwartz Partnership, Kenneth Franzheim II, Zenya Yoshida d.b.a. Shadai Farms, Earl H. Shultz, Robert D. Stratmore, and Richard D. Schultz (collectively the "Klein appellees").

A. Is this appeal timely?

The Federal Rules of Appellate Procedure require that a party file a notice of appeal "within 30 days after the date of entry of the judgment or order appealed from." Fed. R. App. P. 4(a)(1). Bryant's notice of appeal was filed more than thirty

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** This disposition is not appropriate for publication and may not be cited to or by the courts of this circuit except as provided by 9th Cir. R. 36-3.

days after the order denying Bryant's motion for attorneys' fees against appellees Shultz, Barry K. Schwartz Partnership, Franzheim and Yoshida. The Klein appellees argue that therefore the appeal is not timely as to that set of appellees.

However, appeal is permitted under 28 U.S.C. § 1291 "only when there is a final judgment that resolves all of the consolidated actions unless a [Rule] 54(b) certification is entered by the district court." *Huene v. United States*, 743 F.2d 703, 705 (9th Cir. 1984). The final orders in *Stratmore v. Combs* and *Central Bank & Trust Co. v. McGonigle* were not filed until November 22, 1996. Bryant filed a notice of appeal within thirty days — on December 18, 1996. Because the *Stratmore* and *McGonigle* cases were consolidated for trial with other cases herein appealed, under *Huene* Bryant could not appeal until November 22, 1996. The thirty-day clock did not start until then. Bryant's appeals are therefore timely.

B. Did the district court act within its discretion in declining to award Bryant attorneys, fees under § 11(e)?

1. Standard of review.

District courts may award attorneys' fees under § 11(e) for claims which "bordered on the frivolous." *Layman v. Combs*, 994 F.2d 1344, 1353 (9th Cir. 1992), *cert. denied*, 114 S. Ct. 303 (1993).

This court reviews the district court's decision not to award attorneys' fees under § 11(e) for abuse of discretion:

> The statutory language leaves the district court broad discretion to consider and balance the relevant facts

> and policies. We will not disturb the district court's exercise of discretion unless we have a definite and firm conviction that the court committed a clear error of judgment in the conclusion it reached after a weighing of the relevant factors.

Stitt v. Williams, 919 F.2d 516, 531 (9th Cir. 1990).

2. The § 12 claims.

On June 15, 1988, the U.S. Supreme Court defined "seller" for purposes of § 12(1) in *Pinter v. Dahl*, 486 U.S. 622, 100 L. Ed. 2d 658, 108 S. Ct. 2063 (1988). The Court rejected the Ninth Circuit's "substantial factor" test and defined seller as one who "successfully solicits the purchase, motivated at least in part by a desire to serve his own financial interests or those of the securities owner." Id. at 647. In September 1988 Bryant moved for summary judgment on the § 12 claims, which the district court granted in December 1988, ruling that Bryant was not a "seller" under the new *Pinter* standard.

Under the pre-*Pinter* standard for "seller," "the test is whether the injury to the plaintiff flowed directly and proximately from the actions of the defendant." *SEC v. Seaboard Corp.*, 677 F.2d 1289, 1294 (9th Cir. 1982). A defendant's actions must be "both necessary to and a substantial factor in the sales transaction." *SEC v. Murphy*, 626 F.2d 633, 650 (9th Cir. 1980).

Under either standard, Bryant was clearly not a seller for purposes of § 12. Bryant never spoke to any of the Klein appellees before they invested; nor did he draft the private placement memorandum or its supplement. He had no effect on their investment decisions. It is thus impossible to argue that he

was "both necessary and a substantial factor in the sales transaction," or that he "successfully solicited" the purchases in any way. The § 12 claims against Bryant bordered on the frivolous; the district court abused its discretion in denying attorneys' fees to Bryant. We thus remand for the district court to issue an appropriate award of attorneys' fees to Bryant.

3. The § 17 claims.

In July 1987 this court announced that it no longer recognized a private right of action under § 17(a). *In re Washington Pub. Power Supply Sys. Sec. Litig. (WPPSS)*, 823 F.2d 1349, 1358 (9th Cir. 1987). Since the Klein appellees consented to the dismissal of their § 17 claims as soon as *WPPSS* rendered them meritless, the district court did not abuse its discretion in denying attorneys' fees as to these claims.

II. Appeals of Casares and Schultz.

The district court granted attorneys' fees from Casares and Schultz to Bryant, Kemper and Hembree under the Florida and Ohio fee-shifting statutes. Fla. Stat. Ann. § 517.211(6); Ohio Rev. Code § 2923.34(G) & (H). The district court ordered Casares and Schultz to pay five percent of appellees' total legal fees, which amounted to awards ranging from approximately $ 35,000 to $ 80,000. We reversed and remanded for the district court to recalculate the attorneys' fees. *Schultz*, 975 F.2d 572 at 577 (9th Cir. 1992). On remand, the district ordered Casares to pay Hembree approximately $1.7 million, Kemper approximately $ 800,000, and Bryant approximately $ 1.2 million. The district court ordered Schultz to pay Hembree approximately $ 1.9 million, Kemper approximately $ 1 million, and Bryant approximately $ 1.1 million. The district court also

awarded supplemental fees and costs incurred in connection with the first appeal and proceedings on remand.

A. Standard of Review.

This court reviews awards of attorneys' fees for abuse of discretion. *Layman*, 994 F.2d at 1353 n.6. "However, a district court abuses its discretion if it rests its conclusion on an erroneous legal premise, and questions of law are reviewed de novo." *Id.* (quoting *FSLIC v. Sahni*, 868 F.2d 1096, 1097 (9th Cir. 1989)).

B. The district court correctly applied *Schultz v. Hembree.*

In *Schultz v. Hembree*, this court reversed the district court's award of attorneys' fees, and remanded for the district court to recalculate fees using the stand-alone approach:

> We hold that the prevailing party may recover that amount in fees it would have incurred had the shifting claims been litigated by themselves. This amount may well differ from the amount actually expended in advancing (or defending against) the claim in the context of the multiple-claim litigation. It might be less, if the parties would have litigated the shifting claims less vigorously, or compromised them early in the litigation. Or it might be more, as the parties may have devoted more resources to the shifting claims had they not been distracted by others. In any event, this method avoids both overcompensating and undercompensating the prevailing party, because the fees award is pegged precisely to the claim under which it is authorized.

975 F.2d at 577.

Casares and Schultz argue that the district court failed correctly to apply this methodology. First, they argue that the district court erred in not requiring appellees to present new evidence of what attorneys' fees would have been in a hypothetical stand-alone case. This argument lacks merit. The evidence of what fees actually were expended is the best evidence of what fees would have been in a hypothetical stand-alone case. The district court and appellees took the actual fees expended on the shifting claims, and then adjusted them to account for how the litigation would have differed in a stand-alone case. For instance, the district court added $ 240,000 in fees regarding insurance litigation that would have been incurred in a stand-alone Ohio RICO claim. Moreover, neither Casares nor Schultz suggested any contrary methodology or evidence.

Second, Schultz argues that the district court refused to consider what course the litigation would have taken had the Ohio RICO claim been litigated alone. Before the district court, Schultz argued that (1) given the weakness of his claim, appellees would have defeated the claim with only $ 2000 of legal work from each appellant, and (2) appellees would have settled the claim before expending the $ 4.1 million in legal fees they were ultimately awarded. The district court, however, did not refuse to consider these arguments. Instead, the district court found that factually it was not credible that the claim would have been dismissed after only $ 2000 in legal work. Likewise, the district court noted several reasons why the appellees would not have settled so early. Not only did the appellees face millions in direct claims, and the possibility of being collaterally estopped in future litigation against the purchasers of the public offering; they also faced the damage to their professional reputations which any settlement would have brought.

Schultz and Casares also argue that appellees failed to differentiate between shifting and non-shifting claims and between the Ohio and Florida shifting claims. This argument is incorrect. All three appellees did distinguish between shifting and non-shifting claims, and between Ohio and Florida shifting claims. Kemper and Bryant went through their fees line-by-line and identified each entry as work that would have been performed (1) in a stand-alone Ohio RICO case; (2) in a stand-alone Florida blue-sky case; (3) in both cases; or (4) in neither case. Hembree used a slightly different methodology. He divided the litigation into five phases, and for each phase he decided what percentage of the fees expended would have been expended in a stand-alone Ohio RICO or Florida blue-sky claim. Both methodologies differentiate between the claims. If Casares or Schultz disagreed with the allocation among the claims, they should have raised these problems below, which they did not.

Schultz's only compelling argument is that he should not pay the costs associated with the statute of limitation defense, since that defense did not apply to his Ohio RICO claim. He raised this argument in his motion for reconsideration, which the district court denied. An argument is not waived if it is raised for the first time in a motion for reconsideration. *Whittaker Corp. v. Execuair Corp.*, 953 F.2d 510, 515 (9th Cir. 1992). Schultz argues that his Ohio RICO claim presented no statute of limitation issue. The Ohio RICO statute has a five-year limitation period. Ohio Rev. Code § 2923.34(K). Schultz's second complaint was filed on March 8, 1988, less than five years from the date on which he invested. We remand for the district court to determine whether the statute of limitation defense applied to Schultz's claim, and if not, to recalculate the fee award against Schultz accordingly.

C. The district court did not err in failing to explain the reasonableness or justness of the fee award.

Schultz v. Hembree requires the district court to "provide a clear and concise explanation of its decision, which will inform the parties — and this court, if necessary — of the basis for and reasonableness of the fee award." 975 F.2d at 577. Casares and Schultz argue that the district court failed to explain the reasonableness of the fee award. In fact, the district court made explicit findings that the methods of allocation and computations of Hembree, Kemper and Bryant were reasonable. Furthermore, this court in *Schultz* noted that Casares and Schultz did not challenge the district court's earlier finding that the amounts the defendants expended in attorneys' fees were reasonable. *Id.* at 575.

Casares and Schultz also argue that the district court erred in not making a new finding of justness. Such a finding, however, was not required by *Schultz*, which is the law of the case. *Schultz* required that the district court follow the stand-alone methodology, and then explain why the result was reasonable, which the district court did. Indeed, *Schultz* specifically noted that the issue of justness had already been decided and not appealed, and was not subject to further review: "Casares made no showing that an award of fees would be 'unjust,' nor could he . . . . Schultz makes no claim that such an award would be unjust." Id. at 575 and n.3. Under *Schultz*, the district court did not need to make an explicit determination of justness.

D. The district court did not abuse its discretion in denying discovery.

Casares and Schultz argue that the district court abused its discretion in denying their request for discovery. It appears,

however, that Casares and Schultz never properly requested discovery. The district court noted that although Casares and Schultz "said in their briefs they would like some discovery," they requested no "specific" discovery. "Unfocused requests to initiate discovery without indicating its nature or extent serve no purpose, and the District Court has full discretion to deny such requests." *National Ass'n of Concerned Veterans v. Secretary of Defense*, 219 U.S. App. D.C. 94, 675 F.2d 1319, 1329 (D.C. Cir. 1982).

Moreover, the district court would have had discretion to deny the request even had it been properly made. "Broad discretion is vested in the trial court to permit or deny discovery, and its decision to deny discovery will not be disturbed except upon the clearest showing that denial of discovery results in actual and substantial prejudice to the complaining litigant." *Sablan v. Department of Fin. of N. Mariana Islands*, 856 F.2d 1317, 1321 (9th Cir. 1988) (citations omitted). Since Casares and Schultz have still not specifically identified what they desire discovery of, i.e. what gaps in the record they believe that discovery could fill, the district court did not abuse its discretion in denying discovery.

Conclusion

We REVERSE the district court's denial of attorneys' fees to Bryant under § 11(e), and REMAND for the district court to issue an appropriate award of attorneys' fees. We AFFIRM the district court's award of attorneys' fees to Bryant, Hembree and Kemper against Casares and Schultz, except we REMAND for the district court to determine whether the statute of limitation defense would have applied to Schultz's stand-alone claim, and if not, to recalculate the attorneys' fee award against Schultz accordingly.

APPENDIX B — EXCERPT OF TRANSCRIPT OF PROCEEDINGS FROM THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF CALIFORNIA DATED JUNE 14, 1994

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

BEFORE THE HONORABLE CHARLES A. LEGGE, JUDGE

NO. C-87-1129 CAL

BLAS R. CASARES,

PLAINTIFF,

VS.

SPENDTHRIFT FARM, ET AL.

DEFENDANTS.

NO. C-88-3175 CAL

RICHARD D. SCHULTZ,

PLAINTIFF,

VS.

BATEMAN EICHLER, HILL, RICHARDS, INC., ET AL.,

DEFENDANTS

SAN FRANCISCO, CALIFORNIA
TUESDAY, JUNE 14, 1994

Appendix B

TRANSCRIPT OF PROCEEDINGS

* * *

REPORTED BY: LAWRENCE J. WHITE, CSR, CP, CM
OFFICIAL REPORTER, USDC

* * *

[44]

* * *

Now, the first decision deals with the question of Mr. Bryant's motion for fees under Section 11(e) of the Securities Act of 1933. And this is a motion directed by defendant Mr. Bryant against all of the plaintiffs.

The legal standard for that was defined in this case in the *Layman v. Combs* decision, 994 F.2d 1344, at pages 1353 through 1354. That standard was that I can award fees under 11(e) if the plaintiffs' causes of action, quote, border on the frivolous. The case was remanded to me to determine which claims bordered on the frivolous and to consider awarding Mr. Bryant attorney's fees on those claims.

It is clear that I did award summary judgment to Mr. Bryant. It's part of a rather lengthy order. I believe it's the one dated — well, the date stamp is terrible. Let me see if I signed it with a date. I believe that was December 22 of 1988.

Now, with respect to this language in my first order dealing with the attorney's fees stating bordered on the frivolous, it's

obvious that I did use an incorrect legal standard. I thought the standard was higher than that. And counsel pointed out to me in their briefs that both of you steered me in the right direction, but I got off the track anyway.

Nevertheless, when I made my bordered on the [45] frivolous content the first time, it was in the context of an incorrect legal standard. And so I believe I have to readdress the whole question. And also I believe that I have gone back and reread the statement I made, and I believe it was in the context of recovering to the Ohio and to the Florida Blue Sky claims. I refer to page 39 of the transcript of the hearing of August 17, 1989.

I don't believe, on rereviewing this matter under the appropriate standard now directed to me by the circuit, that any of these claims by the plaintiffs generally bordered on the frivolous. I believe there were some very close summary judgment — sorry — statute of limitations issues. There were some dismissals by the plaintiffs themselves.

I previously denied some motions to dismiss. Some of the claims needed some fact development. And, indeed, during the course of the litigation, there were some changes in the law. I also note that the Section 11(e) standard is a discretionary standard to be applied by me, and for those reasons Mr. Bryant's motion under Section 11(e) is denied.

* * *

APPENDIX C — ORDER OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF CALIFORNIA FILED JULY 1, 1994

No. C-86-1692 CAL
No. C-86-3464 CAL
No. C-86-3673 CAL

GEORGE E. LAYMAN, et al.,

Plaintiffs,

vs.

BROWNELL COMBS II, et al.,

Defendants.

ORDER DENYING DEFENDANT BRYANT'S MOTION TO RECOVER ATTORNEYS' FEES UNDER SECTION 11(e) OF THE 1933 SECURITIES ACT

On June 14, 1994, defendant Frank L. Bryant's motion to recover attorneys' fees under section 11(e) of the 1933 Securities Act (15 U.S.C. §77k(e)) came on for hearing, argument and consideration by the Court. Thomas K. Bourke, Esq. of Turken, Melman & Bourke appeared on behalf of defendant Bryant and Michael J. Bettinger, Esq. of Pillsbury Madison & Sutro appeared on behalf of plaintiffs in the above-entitled actions. The Court, having reviewed the briefs and heard oral argument, being fully apprised of the matters stated therein and good cause appearing,

IT IS ORDERED that:

Appendix C

Plaintiffs claims against defendant Bryant under sections 12(1), 12(2) and 17(a) of the 1933 Securities Act (15 U.S.C. § 771(1), 771(2) and 77q(a)) did not border on the frivolous. Defendant Bryant's motion for attorney's fees under section 11(e) of the 1933 Securities Act (15 U.S.C. § 77k(e)) is therefore DENIED.

Dated: July 1, 1994

Charles A. Legge
United States District Judge

APPENDIX D — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT IN THE MATTER OF *LAYMAN v. COMBS* FILED DECEMBER 17, 1992 AND AMENDED MAY 12, 1993

GEORGE E. LAYMAN, et al.,

Plaintiffs,

v.

BROWNELL COMBS, II, et al.,

Defendants.

[and related cases]

No. 89-16621, No. 89-16622, No. 89-16623, No. 89-16641, No. 89-16642, No. 89-16644, No. 89-16646, No. 89-16647, No. 89-16648, No. 89-16650, No. 89-16651, No. 89-16657, No. 89-16658, No. 89-16660, No. 89-16665, No. 89-16666, No. 89-16667, No. 89-16670, No. 89-16674, No. 89-16675, No. 89-16680, No. 89-16684, No. 89-16686, No. 89-16688, No. 89-16690, No. 89-16692, No. 89-16696, No. 89-16698, No. 89-16726

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

994 F.2d 1344; 1992 U.S. App. LEXIS 37576;
93 Daily Journal DAR 5992

September 13, 1991, Argued, Submitted,
San Francisco, California
December 17, 1992, Filed

SUBSEQUENT HISTORY: Amended May 12, 1993.

Appendix D

PRIOR HISTORY: Appeal from the United States District Court for the Northern District of California. D.C. No. CV-86-1692-CAL. D.C. No. CV-86-3474-CAL. D.C. No. CV-86-3474-CAL. D.C. No. CV-86-3673-CAL. D.C. No. CV-86-0379-CAL. D.C. No. CV-88-3175-CAL. D.C. No. CV-87-1129-CAL. D.C. No. CV-86-4129-CAL. D.C. No. CV-87-0228-CAL. Charles A. Legge, District Judge, Presiding.

* * *

JUDGES: Before: William C. Canby, Jr. and Alex Kozinski, Circuit Judges, and Earl H. Carroll,* District Judge.

Opinion by Judge Canby; Dissent by Judge Kozinski.

OPINION BY: CANBY

OPINION: AMENDED OPINION AND ORDER

CANBY, Circuit Judge:

Certain defendants in *McGonigle v. Combs*, 968 F.2d 810, slip op. 7223 (9th Cir. 1992), appeal the district court's summary judgment rejecting their counterclaim for attorneys' fees.[1] The counterclaim alleged that the defendants were entitled to recover their fees because the plaintiffs' breaches of certain warranties triggered an indemnification clause to which plaintiffs had

* The Honorable Earl H. Carroll, United States District Judge for the District of Arizona, sitting by designation.

1. Defendant Frank Bryant also claims certain other damages arising from the plaintiffs' breach of warranties, which he asserts are covered by the indemnity clause.

agreed. In addition, defendant Frank Bryant appeals the district court's denial of his requests for attorneys' fees under Section 11(e) of the Securities Act of 1933, 15 U.S.C. § 77k(e) (1988), Rule 11 of the Federal Rules of Civil Procedure, and Rule 37(c) of the Federal Rules of Civil Procedure. We reverse and remand the district court's denial of Bryant's request for attorneys' fees under Section 11(e), and we affirm the district court's rejection of the remaining claims.

THE DEFENDANTS' CONTENTION THAT THE SUBSCRIPTION AGREEMENT ENTITLES THEM TO ATTORNEYS' FEES

Factual Background

This counterclaim is one of many components of a complex securities litigation involving Spendthrift Farms, a thoroughbred horse breeder. Plaintiffs were investors in a private placement of Spendthrift stock; when the thoroughbred market declined, they sued a string of defendants, alleging a variety of fraudulent acts and omissions. The district court granted summary judgment for the defendants on most of the claims and directed a verdict on several others; the jury returned a complete defense verdict on the remaining claims. The merits of the lawsuit are considered in *McGonigle v. Combs*, and other related issues are treated in *Schultz v. Hembree*, 975 F.2d 572, slip op. 7321 (9th Cir. 1992).

After the defendants prevailed on all counts, several of them — Frank Bryant; Robert McGuiness and his employer, the investment banker Bateman Eichler, Hill Richards, Incorporated; and Charles Hembree and his law firm, Kincaid Wilson, Schaeffer & Hembree, P.S.C. — pressed this counterclaim seeking reimbursement of the attorneys' fees they incurred. The

basis of these defendants' counterclaim is a subscription agreement attached as an appendix to the Private Placement Memorandum ("PPM") for the private offering of shares in Spendthrift. Each of the plaintiffs signed the subscription agreement in the course of his or her purchase of shares in Spendthrift.[2] The subscription agreement contains, *inter alia*, twenty-two "representations and warranties" that occupy more than three pages of single-spaced type. These representations include, for example, that "it has been called to [the investor's] attention both in the [Private Placement] Memorandum and by those individuals with whom he has dealt in connection with his investment in the shares that his investment in the Company involves a substantial degree of financial risk," and that "[the investor] has received no representations or warranties from the Sellers or any of the Sellers [sic] officers, directors, employees or agents other than those contained in the [Private Placement] Memorandum." Each investor further warrants, among other things: that he has a net worth of at least $ 5,000,000 and is knowledgeable in financial matters; that he has read the PPM; that he understands that the shares are subject to restrictions on transfer; that he is not purchasing the shares with a view to resale; and that he will not sell or transfer his shares without providing the sellers with an unqualified opinion of counsel that the sale or transfer "complies with the 1933 Act and any applicable federal and state securities laws and regulations."

The subscription agreement also contains an indemnification clause, which states as follows:

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2. Investor Blas Casares contends on appeal that he did not sign the agreement until after the stock was issued in his name, and, therefore, that he is not bound by the indemnity provision. In light of our affirmance of the district court's ruling, we do not reach the question whether Casares was bound by that provision.

Appendix D

> 5. Indemnification. The foregoing representations and warranties are made by the Subscriber with the intent that they may be relied upon in determining his qualification and suitability to purchase Shares, and the Subscriber hereby agrees that such representations and warranties shall survive his purchase thereof. The Subscriber hereby agrees to indemnify and hold harmless the Company, the Sellers and agents of each of them from and against any losses, claims, damages, liabilities, expenses (including attorneys' reasonable fees and disbursements), judgements and amounts paid in settlement resulting from the untruth of any of the warranties and representations contained herein, or the breach by the Subscriber of any of the covenants made by him herein. Notwithstanding the foregoing, however, no representation, warranty, acknowledgement or agreement by the Subscriber made herein shall in any manner be deemed to constitute a waiver of any rights granted to him under Federal or State securities laws.

The defendants argue that, in pursuing this litigation, the plaintiffs breached their warranties in the Subscription Agreement by averring, for example, that they relied on representations made by the defendants outside of the PPM and that they were misled into believing that their investment in Spendthrift entailed little risk. The defendants contend that, in light of those breaches, the indemnification clause obligates the plaintiffs to pay the defendants' attorneys' fees.

Discussion

The material facts are not in dispute; the plaintiffs

acknowledged for purposes of summary judgment that they breached certain provisions of the security agreement in bringing their lawsuit. The plaintiffs contend, however, that they are not obligated to reimburse the defendants for their attorneys' fees because the indemnification clause is limited to liability arising from breaches that cause the sellers to lose their private placement registration exemption under SEC Rule 506, 17 C.F.R. § 230.506 (1992), or comparable exemptions under state blue sky laws. The sellers have not lost any such exemption. Thus the only question before us is a straightforward one: Does the indemnification clause obligate the plaintiffs, who are assumed to have breached their warranties, to pay the attorneys' fees of the defendants that were incurred in defending the plaintiffs' unsuccessful claims?[3]

The first page of the PPM states that

> the Sellers will impose certain standards which prospective investors must meet in order to be eligible to purchase the shares. These suitability standards are designed to assure compliance with Section 4(l) of the Securities Act of 1933 and Regulation D promulgated by the Securities and Exchange Commission thereunder and with the Blue Sky Laws of the states in which this offering will be made.

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3. Because none of the parties suggests that we apply any particular state's substantive law, we apply the law of the forum state, California. Under California law, a court interpreting a contract should "look for expressed intent, under an objective standard." 1 B.E. Witkin, *Summary of California Law*, Contracts § 684 (9th ed. 1987); *accord Stevenson v. Oceanic Bank*, 223 Cal. App. 3d 306, 272 Cal. Rptr. 757, 763 (Cal. Ct. App. 1990).

This concern that the offering meet all the requirements for a registration exemption is reflected in the representations and warranties of the subscription agreement, which — as both the plaintiffs and the defendants acknowledge — contain the "suitability standards" mentioned in the sentence above. As a result, many of the representations in the subscription agreement track, verbatim, the language of Regulation D.

More important for our purposes, the opening sentence of the indemnification clause focuses on the suitability standards: "The foregoing representations and warranties are made by the Subscriber with the intent that they may be relied upon in determining his qualification and suitability to purchase Shares, and the Subscriber hereby agrees that such representations and warranties shall survive his purchases thereof." This language indicates that the focus of the indemnification was on ensuring, first, that the suitability standards were met, so that the sellers could retain their private placement registration, and, second, that, if the registration were lost and damages resulted, the investor who caused the loss would be liable.

The defendants would have us focus on the second sentence of the indemnification clause, which states that

> the Subscriber hereby agrees to indemnify and hold harmless the Company, the Sellers and agents of each of them from and against any losses, claims, damages, liabilities, expenses (including attorneys' reasonable fees and disbursements), judgements and amounts paid in settlement resulting from the untruth of any of the warranties and representations contained herein, or the breach by the Subscriber of any of the covenants made by him herein.

The defendants point to the broad language of this sentence in support of their contention that the indemnification is not limited to a loss of the registration exemption, but rather applies to all losses that result from a breach of a representation or warranty — even losses arising from this suit brought by the indemnitors. It is true that this sentence, viewed in isolation, could be read so broadly. But this sentence does not appear in isolation. It immediately follows a sentence focusing on the suitability standards for a private placement exemption. The section of the document in which it appears focuses primarily on the suitability standards. The placement of the indemnification (i.e., immediately after the section on the suitability standards) gives no intimation of a broader purpose than to indemnify for liability arising from loss of the private placement exemption. Moreover, the first page of the PPM sets the stage by focusing on suitability standards. In light of this context, we conclude that the unambiguous[4] expressed intent of the clause is that any investor whose breach of a representation causes the sellers to lose their private placement exemption is obligated to reimburse the sellers for their losses. In our view, a reasonable investor who read the PPM and the subscription agreement would so interpret the indemnification clause.

This analysis comports with that of the leading case on the application of indemnification clauses, *Zissu v. Bear, Stearns & Co.*, 805 F.2d 75 (2d Cir. 1986). *Zissu*, like our case, involved a plaintiff who brought suit under the securities laws, alleging,

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4. The defendants contend that, at most, the clause is ambiguous because the literal language of the indemnity clause can be read to cover this case. They assert that summary judgment is therefore improper. We find no ambiguity, but in any event we conclude, for reasons set forth in the text of our opinion, that no rational trier of fact could attribute to the clause the meaning urged by the defendants.

among other things, that he had relied on certain oral misrepresentations. *Id.* at 76. As was the case here, Zissu had warranted in his subscription agreement that no oral representations had been made to him. *Id.* at 77. Furthermore, the indemnification clause in *Zissu* was similar to the one in this case, in that Zissu agreed to indemnify and hold harmless the sellers "against any and all loss, damage or liability due to or arising out of a breach of any representation or warranty" that he had made in the subscription agreement. *Id.* The clause in *Zissu* did not mention attorneys' fees, and the court underscored that omission, but the court's reasoning went beyond the mere presence or absence of the words "attorneys' fees":

> The "any and all damages" clause of the Subscription Agreement in this case did not meet the requisite level of specificity necessary to hold Zissu liable to reimburse Encore and Bear Stearns for defense costs in their successful defense against Zissu's securities claims. The clause Zissu signed did not put him on notice that he would be responsible for defendants' legal fees incurred in the security fraud suit. In fact, no mention of attorney's fees was made in the indemnification clause. Instead, the warranties in question were necessary to exempt the limited partnership from the requirements of the 1933 Act and are so understood by investors. That being the case, the parties had little reason to expect that such warranties might also be the basis for the counterclaim made in the present case. Thus, although New York courts have held that contractual indemnity provisions for attorneys' fees will be enforced, and broad indemnification provisions like the one here should

> be read to extend to such fees, a higher level of specificity is required when attorneys' fees are being assessed against a plaintiff suing for securities fraud.

Id. at 79-80 (citations omitted).

Zissu thus focused on both the absence of any reference to attorneys' fees and the failure of the indemnification clause to put Zissu on notice that the clause was not limited to reimbursement for the loss of the registration exemption. The defendants suggest that the subscription agreement's reference to attorneys' fees renders *Zissu* inapplicable, but we disagree. Our reading of *Zissu* is that a reference to attorneys' fees is necessary but not sufficient; the crucial element of an indemnification is that it put potential investors on notice that the indemnification is not limited, and instead applies to fees and damages incurred in defending a claim brought by the subscribing indemnitor herself. The placement of the indemnifying language, as well as the language itself, must reveal its scope.

A person who contracts to pay an opponent's attorneys' fees if she sues unsuccessfully is agreeing to a departure from the standard American rule that a party prevailing in a lawsuit is not entitled to recover fees from the loser. *See Alyeska Pipeline Service Co. v. Wilderness Society*, 421 U.S. 240, 247, 44 L. Ed. 2d 141, 95 S. Ct. 1612 (1975). It is not too much to ask that a clause effectuating such a deviation from the norm be explicit. The indemnification clause here is worded most peculiarly if its purpose was to shift fees in a 10b-5 case brought by the subscribing investor. The clause nowhere states that, if the investor breaches a warranty in suing the sellers, and loses, then the investor must pay the defendants' fees. Instead, it promises

that the investor will indemnify the sellers from any losses, including attorneys' fees, arising from untruth of any of the warranties signed by the investor — warranties with the stated purpose of preserving the private placement exemption.

The defendants' position is that the expressed intent of the parties, as literally set forth in the indemnification clause, was to force the investors to reimburse the sellers for all costs and liability resulting from any breach of the representations and warranties. The language thus encompasses this case, they argue. But if the indemnity clause is so interpreted to apply to the plaintiffs' lawsuit for oral misrepresentations, its literal terms would require the plaintiffs to pay the defendants' judgment and attorneys' fees even if plaintiffs prevailed! In our view, the absurdity of such a result — an investor would have a meaningless right to sue, because she would have to pay the judgment and fees of the losing sellers — undermines the reasonableness of the defendants' interpretation of the indemnification.

The defendants respond by pointing out that Section 29 of the Securities Act of 1934, 15 U.S.C. § 78cc (1988) (and its counterpart in the 1933 Act, Section 14, 15 U.S.C. § 77n (1988)) would prohibit a culpable defendant from recovering his losses from the indemnitor plaintiff, thereby eliminating the danger of a successful investor having to reimburse herself. This argument misses the point. We do not suggest that courts would, in fact, require a successful investor litigant to pay her own recovery. The point is simply that, read as the defendants urge, the clause would seem to require that absurd result. That fact suggests to us that the indemnification clause cannot be given the broad reading that the defendants urge. It further suggests that a

reasonable investor would not so interpret the language in agreeing to the clause.[5]

In light of these considerations, we conclude that the indemnification required by the clause in this case does not extend to fees or damages incurred in defending claims brought by the subscribing indemnitor. We therefore affirm the district court's refusal to award attorneys' fees under this clause.

BRYANT'S CHALLENGE TO THE DISTRICT COURT'S REFUSAL TO AWARD FEES UNDER SECTION 11(e) OF THE SECURITIES ACT OF 1933 AND RULES 11 AND 37(c) OF THE FEDERAL RULES OF CIVIL PROCEDURE

In addition to joining the main counterclaim, defendant Frank Bryant brought a counterclaim for his attorneys' fees based on Section 11(e) of the Securities Act of 1933, 15 U.S.C. § 77k(e), Rule 11 of the Federal Rules of Civil Procedure, and Rule 37(c) of the Federal Rules of Civil Procedure.[6]

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5. *Atari Corp. v. Ernst & Whinney*, 981 F.2d 1025, 1031 (9th Cir. 1992) (amended opinion), is clearly distinguishable. There the clause in question indemnified "all present and former officers and directors of the Company to the fullest extent permitted by applicable law with respect to all acts and omissions arising out of such individuals' services as officers, directors or employees of the Company or any of its subsidiaries." Nothing in the context narrowed the immense sweep of the indemnifying language. The clause was accordingly held to cover losses caused by an action brought by the indemnitor. In our case, as we explain in the text, the context discloses a narrower purpose.

6. "We review the district court's rulings on Rule 11 issues under an 'abuse of discretion' standard." *Townsend v. Holman Construction Corp.*, 929 F.2d 1358, 1365-66 (9th Cir. 1990) (en banc). In addition, we

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Appendix D

I. Bryant's Request for Attorneys' Fees Under Section 11(e)

Section 11(e) of the Securities Act of 1933 allows the district court to award attorneys' fees if it "believes the suit or the defense to have been without merit." 15 U.S.C. § 77k(e). "The 'without merit' standard . . . encompasses claims and defenses that . . . border on the frivolous." *Western Federal Corp. v. Erickson*, 739 F.2d 1439, 1444 (9th Cir. 1984) (emphasis added). In its ruling on the defendants' requests for attorneys' fees, the district court stated that, "with respect to some of the claims against Mr. Bryant, McGuiness, [and] Central Bank, that they were — bordered on frivolous." The district court did not award Bryant attorneys' fees under Section 11(e), however, stating that "with respect to Section 11(e), the standard announced by the 9th Circuit is . . . frivolous and brought in bad faith. . . . I didn't think that these claims fall within that category." As Bryant correctly points out, the district court applied an incorrect legal standard to his request for attorneys' fees; the court apparently believed that it had the discretion to award fees only if the claims against Bryant were frivolous, when in fact it could award fees for those that merely bordered on the frivolous. In light of this error, we remand for a determination of which claims bordered on the frivolous, and we direct the district court to consider

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review a district court's decision whether or not to award attorneys' fees for abuse of discretion. *Lange v. Penn Mutual Life Insurance Co.*, 843 F.2d 1175, 1184 (9th Cir. 1988); *Falstaff Brewing Corp. v. Miller Brewing Co.*, 702 F.2d 770, 784 (9th Cir. 1983). "However, a district court abuses its discretion if it rests its conclusion on an erroneous legal premise, and questions of law are reviewed de novo." *FSLIC v. Sahni*, 868 F.2d 1096, 1097 (9th Cir. 1989); *see also Cooter & Gell v. Hartmarx Corp.*, 496 U.S. 384, 405, 110 L. Ed. 2d 359, 110 S. Ct. 2447 (1990); *Cunningham v. County of Los Angeles*, 879 F.2d 481, 487 (9th Cir. 1988), *cert. denied*, 493 U.S. 1035, 107 L. Ed. 2d 773, 110 S. Ct. 757 (1990).

awarding Bryant the attorneys' fees he incurred in defending against those claims.[7]

II. Bryant's Request for Attorneys' Fees Under Rule 11

Bryant suggests that the district court applied an erroneous legal standard in rejecting his request for attorneys' fees under Rule 11 of the Federal Rules of Civil Procedure. He states that the district court applied the standard articulated in the panel decision of *Townsend v. Holman Consulting Corp.*, 881 F.2d 788, 795 (9th Cir. 1989) (Rule 11 sanctions appropriate only when all claims against all parties are frivolous), and that the district court's alleged reliance on Townsend constituted reversible error in light of the en banc court's rejection of the panel's opinion. *Townsend v. Holman Consulting Corp.*, 929 F.2d 1358 (9th Cir. 1990) (en banc) (frivolous claims can be sanctioned even if pleading contains non-frivolous claims). The problem with Bryant's argument is that we have no reason to believe that the district court relied on the Townsend panel decision. The district court, in rejecting Bryant's Rule 11 request for fees, correctly outlined the standard for awarding fees under Rule 11 (omitting any reference to a requirement that all claims must be frivolous) and then stated that "I don't think that any of the claims made here rise to that level." The court's use of "any" indicates that it did not apply the Townsend panel's ruling, and that it concluded that each of the claims was neither frivolous nor brought for an improper purpose. The court did not abuse

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7. Bryant also challenges the district court's finding that the plaintiffs' claims against him were not frivolous. Bryant does not point to any error of law but rather disputes the district court's conclusion that, though some claims bordered on the frivolous, none of them were frivolous. We conclude that the district court did not abuse its discretion in so finding.

its discretion in so concluding. We therefore reject Bryant's challenge to the district court's refusal to award fees under Rule 11.

III. Bryant's Request for Attorneys' Fees Under Rule 37(c)

Bryant asserts that the district court applied an incorrect legal standard in refusing to award him fees under Rule 37(c) of the Federal Rules of Civil Procedure; he suggests that the district court followed the plaintiffs' erroneous contention that they could not be penalized for their refusal to admit ultimate issues of fact. Bryant misreads the district court's ruling. The district court did not indicate that it adopted the plaintiffs' position, nor did it appear to follow an incorrect legal standard. We find no abuse of discretion in the court's ruling. We therefore reject Bryant's contention that the district court erred in refusing to award attorneys' fees under Rule 37(c).

CONCLUSION

We affirm the district court's refusal to grant attorneys' fees under the indemnification clause of the subscription agreement. We also affirm the district court's denial of Bryant's request for attorneys' fees under Rules 11 and 37(c) of the Federal Rules of Civil Procedure. We remand to the district court Bryant's request for attorneys' fees under Section 11(e) of the Securities Act of 1933, so that the court can apply the proper standard.

All parties except defendant-appellant Bryant are to bear their own costs on this appeal. Bryant is entitled to recover his costs from plaintiffs.

AFFIRMED IN PART, REVERSED IN PART, AND REMANDED.

Appendix D

ORDER

The opinion filed December 17, 1992 is amended as follows:

1. A footnote is added, to be indicated at slip op. p. 14620, first paragraph, first sentence, after the word "fees." The footnote states:

> Defendant Frank Bryant also claims certain other damages arising from the plaintiffs' breach of warranties, which he asserts are covered by the indemnity clause.

2. Slip op. p. 14627, lines 5-6, the sentence is modified to "applies to fees and damages incurred. . . ." (thus adding "and damages").

3. Slip opinion page 14628, a footnote is added, to be indicated at the end of the first full paragraph (ending ". . . agreeing to the clause"). The footnote states:

> *Atari Corp. v. Ernst & Whinney*, 981 F.2d 1025 (9th Cir. 1992) (amended opinion), is clearly distinguishable. There the clause in question indemnified "all present and former officers and directors of the Company to the fullest extent permitted by applicable law with respect to all acts and omissions arising out of such individuals' services as officers, directors or employees of the Company or any of its subsidiaries." Nothing in the context narrowed the immense sweep of the indemnifying language. The clause was accordingly held to cover losses caused by an action brought by the indemnitor. In our case, as

we explain in the text, the context discloses a narrower purpose.

4. At slip op. p. 14628, the second full paragraph is amended to state ". . . we conclude that the indemnification required by the clause in this case does not extend to fees or damages incurred in defending claims brought by the subscribing indemnitor."

A majority of the panel have voted unanimously to deny the petitions for rehearing and the panel unanimously votes to deny the suggestions for rehearing en banc.

The full court has been advised of the suggestion for rehearing en banc and no judge of the court has requested a vote to rehear the matter en banc.

The petition for rehearing is hereby denied and the suggestion for rehearing en banc is rejected.

DISSENT BY: KOZINSKI

DISSENT: KOZINSKI, Circuit Judge, dissenting for the most part:

The right to make contracts is more than just a socially useful convention; it's an important aspect of personal autonomy. By contract, we can order some of the most important aspects of our existence: housing, health care, education, the pursuit of a profession or vocation, sometimes even marriage. Having the power to bind ourselves in exchange for similar concessions from others gives us a significant measure of control over our lives.

Appendix D

Signing a contract does not, of course, guarantee we will be better off. A system of mutual, free exchange gives us only the opportunity to better ourselves; business acumen, diligence and luck will affect the final tally. The right to contract therefore means the right to take chances, to play hunches, to make mistakes; it means having to live by our decisions, no matter how they turn out: "Wise or not, a deal is a deal." *United Food & Commercial Workers Union v. Lucky Stores, Inc.*, 806 F.2d 1385, 1386 (9th Cir. 1986).

While my colleagues don't quarrel with these principles, they do much to undermine them. Confronted with a contract clause they find unpalatable, they refuse to enforce it under the guise of interpretation. But the reasons they offer are not merely unpersuasive; they're transparent. The clause in question says precisely what the sellers claim: It entitles them to attorney's fees for litigation arising out of misrepresentations by the subscribers as to what they did and did not rely on. Reasonable minds can differ as to whether such a clause violates public policy; I believe it does not, but the contrary view is certainly defensible. *See* pp. 4802-04 *infra*. Less defensible is ducking the issue by twisting the law of contract beyond recognition. Because I cannot agree with the majority's result, and because I see nothing but mischief growing from the way it gets there, I dissent from all but minor portions of the opinion.

A. We must decide whether the following language in the subscription agreement means what it says:

> The Subscriber hereby agrees to indemnify . . . the Sellers . . . against any losses, claims, damages, liabilities, expenses (including attorneys' reasonable fees and disbursements) . . . resulting from the untruth

> of any of the warranties and representations contained herein, or the breach by the Subscriber of any of the covenants made by him herein.

The majority concedes that "viewed in isolation" this provision could expose the subscribers to liability for the sellers' attorney's fees. Maj. op. at 1351. It's hard to reach any other conclusion:

(1) The subscribers made several warranties, among them that they wouldn't rely on any oral representations in entering the agreement.

(2) They then brought this lawsuit claiming that they in fact did rely on oral representations.

(3) The sellers were required to defend the lawsuit at considerable expense because the subscribers lied when they warranted they wouldn't rely on oral representations.

(4) The indemnity clause holds sellers harmless for losses "including attorney's reasonable fees and disbursements . . . resulting from the untruth of any of the warranties."

(5) The sellers' expenses (consisting largely of attorney's fees) seem to be exactly what the quoted language covers.

Q.E.D.

Recognizing that the quoted language "could be read so broadly," *id.*, the majority nonetheless concludes that it unambiguously provides the contrary. Indeed, "no rational trier of fact could attribute to the clause the [contrary] meaning urged by the defendants." *Id.* at n.3. The majority thus holds that a

trier of fact would have to be drunk or crazy to construe the contract to mean what it says.

California law is just the opposite. If the language of a contract is susceptible to two different meanings, each side is entitled to put on evidence supporting its preferred construction. *See, e.g., Pacific Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co.*, 69 Cal. 2d 33, 37, 69 Cal. Rptr. 561, 442 P.2d 641 (1968). Even if the language seems susceptible to only one meaning, a party may still put on evidence that a second meaning reflects the parties' actual intent. *Id.* at 39-40; see also *Brinderson-Newberg Joint Venture v. Pacific Erectors, Inc.*, 971 F.2d 272, 276-77 (9th Cir. 1992) (following *Pacific Gas*). I don't understand how we can deny the sellers a trial to prove that the parties *in fact* intended that the clause "be read so broadly." Maj. op. at 1351.

B. But why does the majority so categorically reject the plain language of the contract? The indemnification clause follows language, the majority explains, which suggests the warranties were made to ensure compliance with the private placement exemption to the federal securities laws. Maj. op. at 1351. For example, each subscriber agreed not to transfer his shares, as required by Rule 506, the exemption relied on here. *See* 17 C.F.R. §§ 230.506, 230.502(d). Assuring compliance with the securities laws was no doubt the reason for some of the warranties.

Many other warranties do not track the rule, however. Investors in private placements need only be worth $ 1 million, whereas each subscriber here warranted he had a net worth of at least $ 5 million. *Id.* § 230.501(a)(5). The subscribers also said they understood the financial statements were unaudited,

even though the SEC rules don't require audited statements for Rule 506 offerings, nor any such warranties by subscribers. *Id.* § 230.502(b). Similarly, each investor warranted he had read the offering memorandum, and that the books and accounts of the company were available to him; the regulations state that "the issuer is not required to furnish [such information] to any accredited investor," *id.* § 230.502(b)(1), which all of these subscribers were. Clearly the sellers sought and obtained warranties beyond those required by the securities laws.

Most telling is the warranty at issue here — that the subscribers weren't relying on representations made outside the offering materials. One searches in vain for this requirement in Rule 506 or anywhere else in the securities laws. How does this dovetail with the majority's conclusion that the warranties served no purpose other than to protect the private placement exemption? What becomes of this warranty under the majority's approach? Are we free to interpret the contract — and declare that no rational trier of fact could do otherwise — so as to render this warranty a nullity?

Left to my own devices, I'd just read the disputed language as written. But if we're going to triangulate the meaning of the indemnity clause by reference to neighboring clauses, surely we must look at all such clauses. The majority does the sellers an injustice by failing to even acknowledge these other provisions.

C. The majority also maintains the indemnity provision wasn't specific enough to put the subscribers on notice. See Maj. op. at 1351-52. It relies on *Zissu v. Bear, Stearns & Co.*, 805 F.2d 75, 79-80 (2nd Cir. 1986), for the proposition that the subscribers weren't fairly apprised they could be liable for

attorney's fees if their securities suit was unsuccessful. But the indemnity clause at issue in Zissu only provided for indemnity "against *any and all loss*, damage or liability due to or *arising out of a breach* of any representation or warranty." *Id.* at 77 (emphasis supplied by *Zissu*). Accordingly, Zissu refused to enforce the agreement because "no mention of attorneys' fees was made in the indemnification clause." Id. at 79. The Second Circuit left room for the use of such a clause, but held that "a higher level of specificity is required when attorneys' fees are being assessed against a plaintiff suing for securities fraud." Id. at 80.

Here we have just such a higher level of specificity: Every subscriber agreed to indemnify the sellers "from and against any losses, claims, damages, liabilities, [and] expenses (*including attorneys' reasonable fees and disbursements*) . . . resulting from the untruth of any of the warranties" (emphasis added). The lack of notice that troubled the Second Circuit in Zissu just isn't a problem here. *See Barnebey v. E.F. Hutton & Co.*, 715 F. Supp. 1512, 1519-22 (M.D. Fla. 1989).

More fundamentally, I question the majority's solicitude for these subscribers. These weren't mom and pop investors who mortgaged their retirement to buy palladium mines in Zanzibar. They weren't forced into the contract by economic duress; they weren't badgered by salesmen who pounded down their doors on Saturday morning. These were seasoned business people who commanded considerable resources. Many of them had substantial experience with horse breeding; some had already been doing business with Spendthrift.[1] Most retained

1. Typical is Robert Stratmore, an attorney who specialized in equestrian law and transactions, who grossed more than $ 15 million in

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independent investment advisers and lawyers, and took their sweet time buying into the deal.[2] They risked what they warranted were disposable resources, hoping to get even richer. They gambled — and they lost.

Under these circumstances, what on earth does it mean to say the subscribers didn't have notice of the attorney's fee indemnity clause? It's axiomatic that a contract gives its

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thoroughbred trading the year of the Spendthrift offering and who holds lifetime breeding rights to Triple Crown winner Seattle Slew. *See* VII Joint ER, tab 20, exh. Q, at 149, 192. As defendants point out in their briefs, other subscribers included international fashion mogul Calvin Klein; Zenya Yoshida, Japan's largest and most prominent horse breeder; and the Layman family, who has been involved with thoroughbred horses for over thirty years. *See* Defendants' Brief at 8 & n.4.

2. For example, Barry Schwartz asked his lawyer and investment advisor, Ralph Finerman, to review the PPM. IV Joint ER, tab 19, exh. D, at 20, 99, 103. Attorney Finerman holds a masters degree in taxation and is a CPA. *Id.* at 12. Finerman first heard about the Spendthrift placement on June 20, 1983, and began reviewing the documents the next day. *Id.* at 99, 103. Finerman carefully studied the agreement, id. at 103, and had several conversations with persons at Spendthrift about the deal, *id.* at 104-05. Finerman discussed the fruits of his research thoroughly with Schwartz before advising him to sign onto the deal. *Id.* at 118. Although Finerman made an initial, tentative decision around July 1st, 1983, VIII Joint ER, tab 22, exh. I, at 144, Schwartz didn't sign the agreement until July 13, 1983, three weeks after first receiving it. I Joint ER, tab 4, at 3. *See also* V Joint ER, tab 20, exh. F (George E. Layman, Jr., reviewed the deal with both an attorney and an accountant); IV Joint ER, tab 19, exh. E (Earl Schultz had two legal advisors, as well as the legal department of one of his companies, review the transaction before signing); VI Joint ER, tab 20, exh. P (Zenya Yoshida's attorney approved the deal).

signatories notice of what it says. We may blunt the cutting edge of this principle when one of the parties is illiterate, or subject to economic duress, or when we see legal filigree buried deep within a long, printed contract. But what justifies departing from this principle here? If these subscribers can't be held to the terms of the contract they signed, who ever can?

D. We get a glimpse of what animates the majority's legal aerobics in the part of the opinion where they dispatch the sellers' suggested interpretation: "But if the indemnity clause is so interpreted to apply to the plaintiffs' lawsuit for oral misrepresentations, its literal terms would require the plaintiffs to pay the defendants' judgment and attorney's fees even if plaintiffs prevailed!" Maj. op. at 1352. The majority twice describes this as an absurd result, but nowhere really explores the issue. Which is too bad, because this is the meat of the coconut — the difficult public policy question at the heart of this dispute.

Before addressing this issue, however, I note that the majority does more than interpret the contract. By twice labelling the result suggested by the sellers as "absurd," the majority is saying it wouldn't enforce the clause even if the contract clearly and unambiguously provided what the sellers claim it does, and even if it gave ample notice to the subscribers. An absurd result, after all, remains absurd even if it's explicitly enshrined in the contract. The majority thus writes off what might be a perfectly acceptable and useful provision in a private placement agreement without even a close look. It would be far better if the majority confronted the issue squarely.

The majority's error begins and ends with its phrasing of the issue. After all, if you assume a securities law violation, it

makes no sense to suggest that a defrauded plaintiff will have to indemnify the defrauding defendant by paying back the 10b-5 judgment plus attorneys' fees. But the whole purpose of a provision like the one we are construing is to forestall a 10b-5 violation by limiting the information the investors rely on. Properly framed, the critical question here is: May sophisticated, well-counselled parties, using disposable assets, dealing at their leisure and from arms' length, limit by contract what information they will consider in making a major investment?

A perfectly respectable argument can be made that such a provision runs afoul of section 29(a) of the Securities Exchange Act of 1934, which states that "any condition, stipulation, or provision binding any person to waive compliance" with the federal securities laws and regulations is void. 15 U.S.C. § 78cc(a); *see also id.* § 77n. Enforcement of the indemnity provision could be seen as a waiver of the securities laws because it bars securities lawsuits based on misstatements of fact not contained in the offering materials. Rule 10b-5, after all, prohibits "any untrue statement of a material fact . . . in connection with the purchase or sale of any security," not merely those made in the private placement memorandum. 17 C.F.R. § 240.10b-5 (emphasis added). Giving effect to the indemnity clause might prevent a meritorious securities action based on misrepresentations made by the promoters orally or in writings outside the formal offering package. An indemnity clause could thus be viewed as an end-run around the securities laws.

In fact, it's the very opposite. The whole point of requiring a written prospectus that conforms to the SEC's precise guidelines, *see* Reg. D, 17 C.F.R. §§ 230.501-508, is to ensure that the parties rely on unbiased written data, not on half-whispered oral representations. Letting parties warrant that they

are relying only on those offering materials serves this policy admirably: It forces potential subscribers to look closely at the written materials and avoids the ambiguity and claims of fraud inevitably fostered by collateral oral promises. The warranty, moreover, focuses on reliance, the key element in establishing liability under Rule 10b-5. *See Basic, Inc. v. Levinson*, 485 U.S. 224, 243, 99 L. Ed. 2d 194, 108 S. Ct. 978 (1988) (misstatements lead to liability only if they're relied on); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 206, 47 L. Ed. 2d 668, 96 S. Ct. 1375 (1976) (same). Reliance is, by its nature, subjective; it's easily fabricated or distorted, particularly after the deal sours. Letting parties agree about what they will and will not consider in making a sophisticated, face-to-face securities investment would avoid the cost, uncertainty and delay of securities litigation that now turns on inherently unknowable mental processes.

Much is at stake here for everyone involved. This litigation — although it resulted in a complete defense victory, mostly on summary judgment — devoured a staggering quantity of productive resources. The record consists of 50 cubic feet of paper and weighs over half a ton. There were 4500 entries in the docket sheets below, including almost 400 orders and rulings by the district court. Fifty-seven briefs, consisting of nearly 1800 pages, were filed on appeal, yielding three published opinions. *See Schultz v. Hembree*, 975 F.2d 572 (9th Cir. 1992); McGonigle v. Combs, 968 F.2d 810 (9th Cir. 1992). Some 200 attorneys contributed to this conflagration, supported by legions of paralegals, summer associates and other staff. The attorneys' fees, for the seven defendants who requested them, amounted to more than $ 3.5 *million*. This says nothing of the fees incurred by the 13 plaintiffs and the 14 defendants who didn't request reimbursement; it doesn't take into account other litigation expenses such as photocopying, telephone, facsimile and

messenger charges; deposition transcripts; airfares, limousines and hotel rooms; power meals in swank restaurants. *See generally* Lisa Gibbs, *Skadden Calls Fee Routine; Florida Calls It Gouging*, American Lawyer, July/Aug. 1991, at 19 (billing dispute involving, among other things, a $ 17 fee for courier delivery of a 75-cent newspaper).

Chasing down ephemeral oral representations may be great fun for the lawyers — and so profitable, too — but it does nothing to ensure the integrity or regularity of our securities markets. To the contrary, fear of this type of scorched earth litigation — the juridical equivalent of the firebombing of Dresden — will only discourage people like the sellers from entering into such transactions. That the plaintiffs were able to inflict major financial damage on their adversaries, using as their launch vehicle a case so thin it was never allowed to reach the jury,[3] will surely send a chill down the spine of anyone contemplating selling securities — or engaging in any other type of business — in our litigation-minded society. Assuming, as we must, that our national interest is served when financial markets function efficiently, unbeclouded by the risk of kamikaze litigation, a clear statement that we *will* enforce a subscriber's warranty he hasn't considered matters outside the offering materials would have an entirely salutary effect.

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3. The case of Frank Bryant, a Spendthrift consultant, is particularly alarming. His defense was that he joined Spendthrift after the sale of the shares and was not in any way involved in the conception or drafting of the PPM. *See, e.g.*, X Joint ER, tab 28 (Declaration of Frank L. Bryant in Support of his Motion for Summary Judgment or Summary Adjudication of Issues). Defending on this theory, and winning summary judgment, Bryant was nonetheless saddled with approximately $ 900,000 in legal fees. *See* Declaration of Thomas K. Bourke in Support of Bryant's Motion for Award of Attorney's Fees from Casares and Schultz at 3-4. If this is the face of victory, how much uglier could defeat be?

Doing so would inflict no injustice. The subscribers were sophisticated and obviously wielded substantial bargaining power. They got legal and financial advice galore before committing to the deal. *See* nn.1-2 *supra*. Had they relied on oral representations made by the sellers, they could (and should) have said so before the money was paid and the securities delivered. See Henry Klehm III, Comment, *Contractual Shifting of Defense Costs in Private Offering Securities Litigation*, 136 U. Pa. L. Rev. 971, 998-1002 (1988). I see no reason in the language or policies of the securities laws to make for them a softer bed than they've made for themselves.

That's why the majority's twice-asserted declaration of absurdity is entirely beside the (exclamation) point. Of course it would violate public policy, as well as the express terms of section 29(a), for parties to agree to pay back any damages they suffer under the securities laws. But it isn't nearly so absurd — indeed it makes considerable sense — to let parties limit by contract what they will and will not take into account when negotiating sophisticated financial transactions. The majority dismisses a lawful and potentially beneficial device by the use of a punctuation mark.

Conclusion

I agree that the district court applied an incorrect legal standard in ruling on Frank Bryant's request for attorneys' fees pursuant to section 11(e) of the Securities Act of 1933; accordingly, I concur in remanding for a determination of which claims the district court believes bordered on the frivolous. I also agree that the district court didn't abuse its discretion in refusing to award Bryant fees under Fed. R. Civ. Proc. 11 and 37 (c). But I strongly disagree with, and therefore dissent from, everything else in the majority opinion.

APPENDIX E — EXCERPT OF HEARING ON FEE REQUEST FROM THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF CALIFORNIA DATED AUGUST 17, 1989

UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

BEFORE THE HONORABLE CHARLES A. LEGGE, JUDGE

NO. C-86-1692 CAL

GEORGE E. LAYMAN, ET AL.,

PLAINTIFFS,

VS.

BROWNELL COMBS, II, ET AL.,

DEFENDANTS.

SAN FRANCISCO, CALIFORNIA
THURSDAY, AUGUST 17, 1989

* * *

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Under Rule 11, the latest pronouncment is from the 9th Circuit. It allows for attorneys' fees under Rule 11 for frivolous filings or those made for some improper purpose, such as personal or economic harrassment.

I don't think that any of the claims made here rise to that level. Perhaps I should say sink to that level. So I'm going to deny the claims under Rule 11.

With respect to Section 11(e), the standard announced by the 9th Circuit is much the same as Rule 11, and that is frivolous and brought in bad faith. Again, I didn't think that these claims fall within that category. So the sanctions for attorneys' fees under 11(e) are also denied.

For the same reasons, essentially the same reasons, I am denying the motions under 28 USC 1987 under the so-called equitable powers of the court and Mr. Bryant's claim under Federal Rule of Civil Procedure 37(c) .

I think Mr. Bryant's case poses a close one, particularly with respect to 37(c). I have to agree with plaintiffs that I don't think you can set up a claim for [41] attorneys' fees by framing an interrogatory or request for admission that deals with a relevant fact and then say, plaintiff, if you don't prove that fact, you have to pay attorneys' fees for the whole case.

Now, I want to comment a bit on these motions for attorneys' fees under Rule 11 and Section 11(e), equitable Section, 1927, and Rule 37(c). I think what the defendants are doing, which is as a result of the plaintiffs' action, is striking at the very heart of the adversary system. I can understand how the defendant feel here. They have been through three or four years of litigation. It has been determined that they have won, that the plaintiffs didn't prove their case.

They spent thousands, indeed hundreds of thousands of dollars defending themselves. So I can understand why they say,

why should any system of justice force us to spend hundreds of thousands of dollars to get a determination that we were right to begin with.

Unfortunately, that is the basic premise of our so-called American Rule with respect to the burden of attorneys' fees. It is not a rule that I am terribly enamored with. As a matter of fact, when I was chairman of the State bar's committee on the administration of justice, we took a good run at changing California law on the subject to provide for reasonable attorneys' fees to prevailing party.

The battle was fought all the way through the state bar [42] and legislature. Ultimately the legislature decided to leave it the way it is. I am afraid that is the rule we have. That has to be the starting premise, and that is each party bears their own attorneys' fees, unless there is a clear-cut statute or rule that shifts that.

The social policy, which I guess that type of provision supports, is a concept of open access to the courts, the free right to make claims with privilege, and certain freedoms of advocacy, open and vigorous advocacy. That rule, which Congress and the courts and the state legislatures placed upon us, seems to me is society stating the better objective to be served is open resolution of disputes in court, allowing that kind of freedom rather than the in terrorum restraints of the loser paying all.

I realize that is little solace to the successful defendants, who spent a lot of money here and now get a determination of nothing more than that they were right. But I am afraid that any change in that policy and any change in that process has to be made by congress or by the state legislatures, or at least by the U.S. Supreme Court sitting in its rule-making capacity.

Appendix E

Also my decision here is impacted somewhat by the fact that not all of my decisions — I guess none of them — have been tested by the 9th Circuit. And some of the calls were close.

I also feel, addressing myself to the attorneys rather [43] than the parties, that it's time to put some of this material behind us, put what we can behind us, at least at this level, that is, the district court level.

I think all of our skins have been worn somewhat thin by the advocacy. I must say its been true on both side. It's time to let that heal. I think the process of advocacy is only made worse by overapplying sanctions and attorneys' fees awards.

Primarily, we are here to resolve the merits of the clients' disputes. That is what we are here for. That has been done, at least at this level. And I dislike turning the litigation over merits to an examination of the ethics of counsel and in presenting that as merits. It's what will be done or has to be done, but I hesitate too do it, decline to do it, any more than the law requires me to do so.

Does this give license for improper conduct in courts? Or as Mr. Burns would say, does this send the wrong message? I don't have an answer to that. It's a difficult balance between vigorous advocacy and ethics. One attorney's vigorous advocacy is another attorney's breach of ethics.

The long-range answer to this problem —and now I am just pontificating and has nothing really to do with the decision in this case — the long-range answer to these things really, I think, lies with the bar and not with the courts or, perhaps, with the legislature. Obviously, the legislature could change it. It really deals, I think right now, with the bar.

Appendix E

[44] competency. Certainly, I have no fault with anybody's competency in this case. There has been a high level of competency on both sides. But in many cases I see these disputes arising, or rising, because counsel are not really competent. Everyone's feelings about ethics. You have to have your feelings for appreciation of the limits of this litigation process, appreciation of the economic futility of some suits being brought, or some defenses being raised, even if they facially have merit.

And whatever happened to the old concept of collegiality of the law where you worked out your problems, talked them out, resolved them, and only presented the court those things that you couldn't do?

I also address your attention to Rule 1 of the Federal Rules of Civil Procedure. The purpose of this whole system is to resolve disputes economically and rapidly. I suppose that gets down to a focus on the merits, litigating on the merits of the cases.

I guess winding up this pontification, this case probably stands as bad an example as any of where the present system we have has resulted in tremendous expense and great hardship, I am sure, for a lot of people. And if we needed a case to cite to the legislature for changing the rule on who gets attorneys' fees, I suppose this would be about as good a one as any to present to them.

* * *

APPENDIX F — SUMMARY JUDGMENT DECISION OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF CALIFORNIA DATED DECEMBER 22, 1988

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

GEORGE E. LAYMAN, et al.,

Plaintiffs,

v.

BROWNELL COMBS II, et al.,

Defendants.

[and related cases]

ORDER ON MOTIONS

Certain of these cases were set for trial in November 1988, and discovery was substantially completed. Prior to the trial date, the parties made numerous motions for summary judgment, partial summary judgment, and other relief. The motions were argued and submitted to the court for decision. Because the issues raised in the numerous motions have a substantial effect on the parties and the scope of the trial, the court vacated the trial date.

The court has now considered the moving papers, the opposing papers, voluminous factual records submitted in support of and in opposition to the motions, the record of the case, the arguments of counsel and the applicable authorities. The court determines that certain decisions can now be made regarding matters as to which there is no genuine issue of

material fact. The court's rulings on the motions are set forth below in paragraph II through XI, and the cases are reset for pretrial and trial as ordered in paragraphs XII and XIII below.

I.

The court has been advised that defendant Spendthrift Farms, Inc. is now in proceedings under Chapter 11 of the bankruptcy laws. All further proceedings in these cases against Spendthrift Farms, Inc. are therefore stayed, pending further order of this court or an order of relief from the stay issued by the bankruptcy court.

II.

Defendants have moved for summary judgment against numerous of plaintiffs' claims on the grounds of statutes of limitation. Those motions pertain to plaintiffs' claims under sections 12(1), 12(2), and 10(b), RICO, and to claims under state securities statutes.

A.

The statute of limitations for claims under section 12 is defined in section 13. Section 13 contains various elements, which must be examined separately in ruling upon these motions.

Section 13 contains an absolute period of limitations of three years, both as to claims brought under section 12(1) and under section 12(2). The three year bar is not subject to estoppel or equitable tolling, but is an absolute bar. However, the statute operates differently with respect to claims under section 12(1) and claims under section 12(2).

The three year bar of claims under section 12(1) runs from the

date "the security was bona fide offered to the public." The securities offered to these plaintiffs were bona fide offered to the public in April 1983, when the private placement memorandum was completed and circulated to potential investors. The court disagrees with plaintiffs' argument that those events were not a "bona fide" offering because of plaintiffs claim that the securities were illegally issued, and with plaintiffs' argument that the private placement must be linked to the public offering in November 1983 for the purpose of determining when there was a bona fide offering. The claims under section 12(1) of the following plaintiffs are barred by the three-year rule of section 13: Casares, Fredericks, Hamilton Partners, Northwood, Gateway, McGonigle, Griggs, R. Schultz, Stratmore (as to the defendants added by the amended complaint in July 1986), and Yoshida.

With respect to claims under section 12(2), section 13 provides that the three year bar runs from "the sale." The court concludes that the dates of sale to plaintiffs were no earlier than July 27, 1983, when the subscription agreements of the buyers were accepted by the sellers. It was only then that any of the parties became legally obligated to complete the securities transactions. *Amoroso v. Southwestern Drilling Multi-Rig Partnership*, 646 F. Supp. 141, 145 (N.D. Cal. 1986); *Radiation Dynamics v. Goldmuntz*, 464 F.2d 876 (2nd Cir. 1972). Therefore, none of plaintiffs' claims under section 12(2) is barred by the absolute three year rule of section 13, except that of R. Schultz.[1]

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1. Plaintiff Casares filed his action on August 1, 1986. He raises questions of fact that his purchase did not occur until August 17, 1983. His subscription agreement is dated July 31, 1986, but Casares declares that he was out of the country at that time, and that it was backdated by the notary. Defendants claim that Mr. Casares became legally obligated after a series of telexes in June of 1983, but in those telexes Casares made his purchase of securities contingent on bank financing. Therefore, whether Mr. Casares' claim is barred by three-year absolute bar of 12(2) is a question of fact, and cannot be resolved in these motions.

Appendix F

Section 13 also contains one year periods of limitation for claims under section 12. Again, the statute operates differently with respect to claims under section 12(1) and claims under section 12(2). For claims under section 12(1) the one year begins from "the violation upon which it is based." For claims under section 12(2), the one year period begins upon "the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence."

As to the claims by plaintiffs under section 12(1), the violations occurred in 1983. The exact date in 1983 is not important, because there is no dispute that all of the relevant sales were made during that year. Unless the running of this statute is estopped or equitably tolled (which is discussed below), all of plaintiffs' claims under section 12(1) are barred by this one year statute, because none was commenced until 1986.

Claims under section 12(2) are barred one year after discovery or after discovery should reasonably have been made. The earliest of these cases was filed on February 1986. The court believes that there is no genuine issue of material fact that plaintiffs discovered, or in the exercise of reasonable diligence should have discovered, the alleged untrue statements or omissions prior to February of 1985. Therefore, unless the running of this statute of limitations is estopped or equitably tolled, all of plaintiffs' claims under section 12(2) are barred by this one year statute of limitations.[2]

2. There is authority that for summary judgment motions the public offering documents put plaintiffs on inquiry, especially where sophisticated investors are involved. *Davis v. Burr & Wilson*, 839 F.2d 1369 (9th Cir. 1988) (inquiry notice based on monthly reports that showed the stock's value was declining); *Volk v. D.A. Davidson & Co.*, 816 F.2d 1406 (9th Cir. 1987) (inquiry notice when plaintiffs received annual report

(Cont'd)

The court concludes that principles of equity or estoppel do not toll the three-year bars of section 13. These are absolute periods of limitation, designed by Congress to provide finality to such actions. The court also concludes that principles of equitable tolling or estoppel do not apply to claims under section 12(1); *Erickson v. Kiddie*, CCH Fed. Sec. L. Rptr. ¶92,889 (N.D. Cal. 1986); *In re Rexplore, Inc.*, 671 F. Supp. 679 (N.D. Cal. 1987).

However, this court is of the opinion that estoppel or equitable tolling can extend the statute of limitations for claims under section 12(2). *In re Rexplore* at 686-88. The conduct of defendants which is necessary to toll the statute is misrepresentation. That is, plaintiffs must show a genuine issue of material fact that defendants so concealed information or mislead plaintiffs that plaintiffs were caused not to pursue their claims. "In most circumstances only affirmative conduct of concealment by the culpable defendant which would lead a reasonable person to believe he had no claim, tolls the statute. However, a passive partner in concealment may be subject to the discovery rule of section 13 where its relationship with the plaintiff imposes a duty to disclose." *In re Rexplore, Inc.*, 671 F. Supp. 679, 688 (N.D. Cal. 1987).

Plaintiffs Franzheim, Layman, Stratmore, Griggs, E. Shultz,

(Cont'd)

and general partner's letter indicating problems); *Kennedy v. Josephthal & Co., Inc.*, 814 F.2d 798 (1st Cir. 1987). The cases cited by plaintiffs suggesting that inquiry notice is almost always a factual issue (e.g., *Admiralty Fund v. Jones*, 677 F.2d 1289 (9th Cir. 1982)) are uniformly *before* the Supreme Court imposed a heavier summary judgment burden in *Celotex Corp. v. Catrett*, 477 U.S. 317 (1986), and most involve less sophisticated plaintiffs.

Appendix F

Casares and R. Schultz raise issues of fraudulent concealment on the part of defendants. E. Shultz, Griggs, and Casares claim that representations made by McGuinness at a shareholder's meeting concealed the basis for their claims. McGuinness reportedly explained the relatively disappointing price for the public offering by saying that it was due to insufficient exposure and the relatively small sales area of Bateman-Eichler. However, those representations to sophisticated investors did not answer the discrepancies between the private placement memorandum and the public offering materials, including the vast difference in asset evaluations. McGuinness' alleged statements were not sufficiently relevant to the private placement to act as concealment or fraud.

Stratmore testified in his deposition that Brownell Combs reassured him in 1985 that "things were going to be going okay. He assured me that with respect to TIME FOR A CHANGE he quote guaranteed me against any loss and that he took that on personally." However, the alleged reassurances by B. Combs in 1985, even if constituting concealment, were too late to toll the statute that had already run. Likewise, R. Schultz declares that he talked with B. Combs in 1985, after seeing an article on Spendthrift. The deposition does not explain what B. Combs said, nor would any statement toll the statute so late in the course of events.

Franzheim and Layman do raise issues of fact with respect to the tolling of the statute. Both plaintiffs declare that they questioned Hembree and B. Combs in late 1983 about the discrepancies between the private placement memorandum and the public offering materials, and were told that a new bookkeeping system accounted for the differences and that the differences were not material. The statements of Hembree and

B. Combs may be imputed to co-conspirators or other defendants who knew of the reassurances and had a duty to disclose to plaintiffs. Plaintiffs have raised issues of fact regarding a possible conspiracy between Hembree, the Kincaid law firm, B. Combs and Guy.

Therefore, all of the plaintiffs' 12(2) claims are barred by the one-year limitation period, except those of Franzheim and Layman.

B.

As to plaintiffs' claim under section 10(b), defendants argue for a uniform statute of limitations borrowed from section 13. However this court believes that the law in this circuit is to the contrary (*Davis v. Burr, Wilson*, 839 F.2d 1369 (9th Cir. 1988); *Robuck v. Dean Witter Co.*, 649 F.2d 641, 644 (9th Cir. 1980)), and that the statute of limitations is the most analogous state statute. In California that is Civil Code Section 338(4), providing a three-year period of limitations, which accrues upon the discovery of the facts constituting the alleged fraud or mistake. That statute applies to the claims of plaintiffs Fredericks, E. Schultz, McGonigle, Griggs, Stratmore and Yoshida, and bars none of those claims. Under applicable concepts of borrowing, the Florida two-year statute would apply to Casares' claim, the Washington three-year statute to Layman's claim, the Texas two-year statute to Franzheim's claim, the New York six-year statute to Schwartz and Klein's and Northwood's claim, and the Ohio four year statute to Hamilton Partners', Gateway's and R. Schultz's claim. Under those applicable borrowed statutes, the claims of Casares and R. Schultz under Section 10(b) are barred. Franzheim's claim is saved by equitable tolling, as discussed above.

Appendix F

C.

Plaintiffs also make allegations under various state securities laws. For purposes of state statutes of limitation, we are concerned with the securities statutes of California, Florida, Kentucky, New York, Ohio, Texas, and Washington.

The statute of limitations for claims under Cal. Corp. Code §§ 25401, 25501, and 25504.1, is the shorter of one year after discovery or four years from the act constituting the violation. Cal. Corp. Code § 25506. As with the section 12(2) claims, all of plaintiffs' claims under these statutes are barred.

Casares' claim under the Florida Blue Sky law is by the two year Florida statute of limitation. Fla. Stat. § 517.301(1).

R. Schultz's claim under Ohio Rev. Stat. § 1707.01, *et seq.* is governed by Ohio Rev. Stat. § 1707.43, which requires an action to be brought within two years after discovery or four years from the date of sale. His claim is barred because it was filed more than two years after notice of the alleged wrongdoing, and because both of his complaints were filed more than four years after he made his investment. R. Schultz's claim for negligent misrepresentation is barred by the four-year statute of limitations provided by Ohio Rev. Code Ann. § 2305.09. The statutory period for claims for fraud, however, does not run until he discovered the fraud, and that is presently an issue of fact. Hamilton Partners and Gateway's claims under 1707.01, *et seq.*, are also barred by the two-year discovery provision. Claims under Ohio Rev. Stat. § 2923, however, are subject only to a five year statute and are not barred.

Claims under the Kentucky, Washington, and Texas blue sky laws are not barred by their statutes of limitation.

Appendix F

Plaintiffs' claims under the New York Martin Act, sections 352-c and 359e, must also be dismissed. *CPC International, Inc. v. McKesson Corp.*, 120 A.D.2d 221, 507 N.Y.S.2d 984 (1st Dist. 1986), held that there was no implied private right of action under the Martin Act. That case has been appealed, but the New York Court of Appeals has not yet reached a decision. A federal court must follow a state court's interpretation of state law. The federal courts in the Southern District of New York have followed the *CPC Internation* case, despite the pending appeal. *In re Gas Reclamation, Inc. Securities Litigation*, 659 F. Supp. 493 (S.D.N.Y. April 9, 1987), *Anderson v. Lowrey*, 667 F. Supp. 105 (S.D.N.Y. August 1987).

D.

Plaintiffs' RICO claims are governed by a federal statute of limitations borrowed from the Clayton Act, which runs four years after the discovery of the wrongful act. *Agency Holding v. Malley-Duff & Associates, Inc.*, __ U.S. __, 107 S.Ct. 2759 (1987). R. Schultz' complaint was filed February 26, 1988. His RICO claim is barred if he had inquiry notice of his claims before February 26, 1984, but the court finds that the issue is one of fact.

III.

Several plaintiffs have filed actions against defendant Frank L. Bryant for alleged violations of section 10(b) and rule 10(b)(5), section 12, RICO, and state law. Bryant earlier moved to dismiss certain of those changes. The court denied those motions, because the complaints contained allegations which the court believed to be sufficient to allege such causes of action against him. Now that discovery has been concluded, Bryant

has moved for summary judgment on all of the claims against him.

The record is now clear that Bryant did not visit Spendthrift until mid June 1983. He became a consultant, with respect to the public offering and not the private placement, effective July 1, 1983. He became a director of Spendthrift in August 1983. Essentially his role was to consult with Spendthrift throughout the public offering, at a fixed salary. He also had the right to acquire shares of Spendthrift stock. Bryant had no role in the preparation or distribution of the private placement memorandum or the private placement memorandum supplement. And the court determines from the record that there is no genuine issue of material fact that Bryant did not withhold any material information from any plaintiff.

With respect to his alleged liability under section 10(b) and rule 10(b)(5), Bryant did not have the requisite scienter, and he made no material misrepresentations and did not fail to disclose any material information which he had a duty to disclose, on which any plaintiff justifiably relied. Bryant has no secondary liability under that section and that rule because he had no actual knowledge of the frauds alleged.

As to his alleged liability under section 12, Bryant was not a seller of Spendthrift securities and did not solicit the purchases of those securities. He does not meet the standard of liability recently defined by the U.S. Supreme Court in *Pinter v. Dahl*, __ U.S. __, 108 S.Ct. 2063 (1988). The court specifically finds that there is no genuine issue that Bryant did not sell or solicit purchases of the Spendthrift securities by plaintiffs Casares, Briggs, or Layman. Bryant's statements made to those parties concerned the future public offering on which Bryant was

working, and he did not make any other material representations or omissions on which plaintiffs justifiably relied.

As to the RICO claims against Bryant, the court finds that there is no genuine issue of material fact as to Bryant's lack of scienter. Nor is there a genuine issue with respect to Bryant's lack of engagement in a pattern of racketeering activity. Summary judgment should be granted to Bryant on plaintiffs' RICO claims, including that under Ohio § 2923.

With respect to state common law claims, plaintiffs have not put forward sufficient evidence to raise an issue of fact that Bryant was responsible for any misrepresentations upon which plaintiffs could have justifiably relied. Common law fraud and negligent misrepresentation are not present on the record.

Because of Bryant's late participation in the events, he cannot be held liable as a seller, an agent of a seller, or a "substantial factor" in the sales transactions under Kent. Rev. Stat. §§ 292.320, 292.340, (private right of action governed by 292.480) or under Rev. Code Wash. §§ 21.20.140, 21.20.010, (private right of action governed by 21.20.430, 21.20.430(3)), or under Tex. Rev. Civ. Stat. Ann. art. 581-33A, 581-7.

Certain of the claims against Bryant are also barred by statutes of limitation as discussed above.

IV.

Action C-88-2577 is between Continental Casualty Company as plaintiff and Frank L. Bryant and Spendthrift Farms, Inc. as defendants. The issue is whether those defendants are entitled to coverage (meaning indemnification, defense, or both),

under policies of insurance issued by Continental. Continental has moved for summary judgment against Bryant, and Bryant has moved for a dismissal or a stay of this action. Spendthrift Farms joined in the briefing, but this court's order will only resolve the motions that are before it; that is, the cross-motions by Continental and Bryant.

There is a dispute between the parties as to whether the law of California or Kentucky should apply to the state law issues. However, this court concludes that it need not distinguish between the law of those two states. Under the law of either state, there is no genuine issue of material fact as to the following decisions.[3]

The underlying actions against Bryant in this series of cases arise out of alleged fraudulent misrepresentations and omissions in connection with the sale of Spendthrift securities. As stated above, the claims against Bryant are for violations of securities statutes, RICO, and common law fraud. The complaints make no claims, and allege no facts, regarding bodily injury or emotional distress damages. And certain plaintiffs have expressly asserted in the record that they are making no such claims.

Policy No. 04-211-26-14 was issued by Continental to Spendthrift Farms. The parties have stipulated for purposes of these motions that Bryant is an "additional insured" under the terms of that policy. Part II of that policy is the coverage for comprehensive general liability. It includes coverage for bodily injury liability and property damage liability which is caused by an occurrence; and it imposes upon Continental a duty to

3. Because the court concludes that these issues may be resolved as a matter of law, Bryant's motion for continuance in order to proceed with discovery on the issues is denied.

defend. The term "bodily injury" is specifically defined in the policy to include bodily injury, sickness or disease. The term "property damage" is defined as physical injury to or the destruction of tangible property. The policy defines an "occurrence" as an accident not expected or intended from the standpoint of Bryant. There is no coverage for Bryant under Part II with respect to the actions against him, because those claims against him are not for bodily injury or property damage and do not constitute an occurrence.

The policy provides additional coverages under Section V-B. It provides coverage (including the obligation to defend) for Bryant for claims of personal injury and advertising injury arising out of the conduct Spendthrift's business. There is no coverage for Bryant under the "personal injury" portion of that coverage (a) for the reasons stated above, and (b) because the definition of personal injury only includes certain specific acts which do not include the matters alleged against Bryant here. The "advertising injury" portion of the coverage can only apply here if the claims against Bryant are for "unfair competition" or for "piracy." The allegations by the plaintiffs against Bryant in these cases, and the facts disclosed in the record, do not set forth any claim for unfair competition or piracy within the terms of the policy.

The same policy also contains a Farmer's Comprehensive Personal Liability Endorsement. However, this policy does not provide any additional coverages for Bryant, because the definitions in this endorsement are the same as in the basic policy. There is also a question as to whether Bryant is an additional insured under this endorsement, but for the above reasons this court need not decide that issue.

The policy also contains a "products hazard." This coverage applies to individuals who have an ownership interest in stallions. However, that coverage is "only with respect to the ownership, maintenance, or use of such stallions." The liabilities claimed against Bryant are not of such a nature.

Policy No. 09-211-31-84 is a combined umbrella liability policy issued to Spendthrift and to Leslie Combs. That policy is excess over the underlying policy, 04-211-26-14. To the extent that it is simply excess insurance, that is, increasing the dollar limits of that underlying policy, it does not provide any additional coverages to Bryant, but simply adopts the definitions of the underlying policy.

However, coverage B of the umbrella policy does provide additional coverages for personal injury, property damage, and advertising injury which are caused by an occurrence. This coverage also imposes an obligation to defend. Bryant is *arguendo* an additional insured under this policy. However, the policy's definition of "advertising injury" does not apply to the claims asserted against Bryant. The definition of "property damage" still means tangible and physical injury to property, which is not involved in these suits. The definition of "personal injury" is broad enough to cover emotional distress damages, but as stated above, no such damages are claimed against Bryant. The court also believes that there is no "occurrence" within the definition of this umbrella policy.

The court therefore concludes that the policies issued by Continental to Spendthrift do not provide coverage to Bryant for the claims made against him in these cases, or with respect to any facts which have been developed in these actions. Since there is no coverage, there is also, now that discovery has been

concluded and this decision made, no further obligation to defend.

Continental's motion for summary judgment against Bryant is therefore granted, and Bryant's motion to dismiss or stay this action is therefore denied.

V.

Defendant Central Bank and Trust Company has been sued by plaintiffs under section 12, section 10(b), RICO, state securities statutes and common law. Central Bank has moved for summary judgment on all of those charges. After reviewing the record submitted by the moving and opposing parties the court is of the opinion that the following decisions can be made without any genuine issue of material fact:

Central Bank's motion with respect to the claims against it under section 12 is granted. Central Bank is not a seller and did not solicit the securities purchases. The court is of the opinion that since *Pinter v. Dahl*, there is no liability under section 12 for alleged aiding and abetting.

Central Bank's motion with respect to the claims under section 10(b) is granted. Plaintiffs have not established a genuine issue of material fact that there were misrepresentations by the bank, *scienter*, and justifiable reliance by plaintiffs. There was no duty on the part of Central Bank to disclose information, so it is not liable for its alleged silence. Central Bank is not liable as an aider and abettor under section 10(b), because it had no actual knowledge of the alleged fraud, had no confidential relationships with plaintiffs that are relevant to this cause of action, and did not engage in any substantial assistance or participation in the sales of the securities.

Plaintiffs' claims under Kentucky, Texas, and Washington blue sky statutes must also be dismissed, as Central Bank is not a seller, an agent of a seller, a "control person," nor a "substantial factor" in the sale.

As to plaintiffs' common law claims, plaintiffs have not raised an issue of fact showing that Central Bank could be held liable for any written misrepresentations, nor any oral misrepresentations upon which any plaintiff justifiably relied. Nor have plaintiffs demonstrated a factual dispute as to scienter.

Plaintiffs' RICO claims are dismissed, because plaintiffs have not put forward facts showing that Central Bank engaged in a pattern of racketeering activity.

Some of the claims against Central Bank are also barred by statutes of limitation as discussed above.

Central Bank's motion for sanctions under Rule 11 of the Federal Rules of Civil Procedure is denied. Central Bank's motion for costs under 28 U.S.C. Section 1927 is denied.

VI.

Defendants Bateman Eichler, Hill Richards, Inc. and Robert J. McGuinness have moved for summary judgment as to all claims brought against them by plaintiffs. The court has reviewed the record filed in support of and in opposition to the motions, and concludes that there are no genuine issues of material fact with respect to the following matters.

Bateman Eichler and McGuinness were consulted to arrange for the public offering of Spendthrift stock, scheduled for late

1983. These defendants were not brokers or investment bankers in connection with the private placement, and they wrote none of the offering materials used in the private placement. Nor did they receive any compensation from the private placement. Four plaintiffs, either individually or through representatives, had some communications with these defendants which may have included some discussion of the private placement. These defendants had no fiduciary relationships with those plaintiffs. And even accepting the plaintiffs' versions of those conversations, they are not sufficient to create liability.[4] The court disagrees with plaintiffs' argument that the private placement and public offering were integrated for the purpose of establishing liability by these defendants.

With respect to the claims against these defendants under section 12, there is no genuine issue of material fact that these defendants did not solicit the purchase of Spendthrift securities in the private placement. And the court does not believe that since *Pinter v. Dahl* there is any aider and abetter liability under section 12.

With respect to the claims under section 10(b), there is no genuine issue of material fact that these defendants did not misrepresent any material fact, did not fail to disclose any material fact, had no knowledge of falsity or material omissions, and had no reckless disregard, on which plaintiffs justifiably relied. These defendants did not have any obligation to disclose any material information which they may have obtained after plaintiffs made their purchases in the private placement; *Jett v.*

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4. Most of the alleged statements concerned the anticipated price for the stock in the later public offering. Even if such statements could be the basis for a misrepresention claim, the actual public offering price was known in November 1983.

Sunderman, 840 F.2d 1487 (9th Cir. 1988) case and *Roberts v. Pete, Marwick and Mitchell*, 857 F.2d 646 (9th Cir. 1988). Plaintiffs have also not shown facts that these defendants had actual knowledge of fraud and substantially assisted in it at the time of the private placement sales, as required by *Harmson v. Smith*, 693 F.2d 932 (9th Cir. 1982).

For the same reasons, plaintiffs' claims under the Washington, Texas, and Kentucky blue sky statutes are dismissed. There is no genuine dispute that at the time of the private placement defendants were not sellers, sellers' agents, control persons, nor "substantial factors" in the sale.

Plaintiffs have not shown facts which could support a finding that defendants had sufficient scienter for a fraud cause of action. Nor have they shown sufficient facts to support a finding of reasonable reliance for an alleged negligent misrepresentation claim.

Plaintiffs' RICO claims must also be dismissed, because they do not raise an issue of fact with regard to these defendants' participation in a pattern of racketeering activity.

As discussed above, certain claims are also barred by statutes of limitation.

The motions for summary judgment of defendants Bateman Eichler and McGuinness are granted.

VII.

Defendant Leslie Combs II ("Combs") and plaintiffs have moved for approval of a settlement agreement entered into

among Combs and plaintiffs, and to bar claims for contribution against Combs by the codefendants who are not settling.

This court has the power to approve a settlement and, if justified by an appropriate record, to bar claims for contribution against Combs under federal and state securities laws. The standard for the exercise of that power has been defined for this circuit in *Smith v. Mulvaney*, 827 F.2d 558 (9th Cir. 1987). Under *Smith v. Mulvaney*, this court must determine, among other things, the relative culpability of the defendants. The appellate court stated that a district court cannot base such a decision upon its own perceptions of the case just by being generally familiar with the proceedings which have occurred. Nor can a district court decide the issue based upon the files in the case of which it might take judicial notice. The Ninth Circuit appeared to hold that the necessary findings had to be made on either a summary judgment standard — no genuine issue of material fact — or perhaps upon an evidentiary hearing.

The parties submitted a substantial factual record, both in support of and in opposition to the motion, which the court has reviewed. In addition, the court has ruled above on motions for summary judgment regarding the statutes of limitation applicable to all defendants, and regarding the liability under section 12, liability under section 10, and liability under other claims alleged by plaintiffs against the defendants. The court also has the benefit of the factual records submitted by the parties in support of and in opposition to the numerous motions for summary judgment ruled on above.

This court believes that based upon that record, and based upon the rulings made above, that this court can rule on the proposed settlement on a summary judgment standard; that is,

no genuine issue of material fact. The court has reviewed the potential liability of Combs, the relative alleged culpabilities among Combs and the other defendants, the amount of potential damages, the proportionality of the proposed settlement, and potential defenses. The court finds that the proposed settlement is fair, just, equitable, entered into in good faith, and that the settlement should operate as a bar to claims for contribution by the non-settling defendants against Combs under federal law and under applicable state law. The motion to approve the settlement, and to bar claims for contribution by the non settling defendants against Combs under federal law and under the state securities laws (except Kentucky and Texas) is therefore granted.

VIII.

As a result of the above decisions, the court believes that the following claims remain by plaintiffs, and against defendants Brownell Combs, Guy, Hembree, and the Kincaid firm. The court is not including Spendthrift Farms, because of its bankruptcy proceedings, or defendants who have or are settling:

Layman: 10b; 12(2); RICO; common law ("CL") fraud and negligent misrepresentation; Wash. 21.20.140, 21.20.010

Schwartz: 10(b); RICO; CL fraud and negligent misrepresentation

E. Shultz: 10(b); RICO; CL fraud and negligent misrepresentation

Franzheim: 10(b); 12(2); RICO; CL fraud and negligent misrepresentation; Kent. or Texas blue sky laws

Appendix F

Griggs: 10(b); RICO; CL fraud and negligent misrepresentation

Yoshida: 10(b); RICO; CL fraud and negligent misrepresentation; Kent. 292.340, 292.320

Casares: RICO; Kent. 292.340, Kent. 292.320; CL fraud and negligent misrepresentation

Fredericks: 10(b); RICO; CL fraud and negligent misrepresentation

Hamilton Partners: 10(b); RICO; CL fraud and negligent misrepresentation; Ohio 2923

Northwood: 10(b); RICO; CL fraud and negligent misrepresentation; Ohio 2923

Gateway: 10(b); RICO; CL fraud and negligent misrepresentation; Ohio 2923

Stratmore: 10(b); RICO; CL fraud, negligent misrepresentation and concealment

McGonigle: 10(b); RICO; CL fraud, negligent misrepresentation and concealment

R. Schultz: RICO; Ohio 2923; CL fraud

IX.

Plaintiffs Griggs, McGonigle, and Yoshida have moved to amend their complaints. The proposed amendments would add a cause of action to each complaint based upon section 12(1).

Appendix F

The court has ruled above upon the application of the statute of limitations in section 13 to the claims based upon section 12(1), and has held that such claims are barred by the statute of limitations. The new causes of action of Griggs, McGonigle, and Yoshida under section 12(1) would also be barred by the statute of limitations, even if the dates of their amendments were related back to the original dates on which those plaintiffs first filed their complaints (June 20, 1986 by Griggs; July 18, 1986, by McGonigle; and June 30, 1986, by Yoshida). The motions to amend are therefore denied.

X.

Defendant Garth Guy has moved to set aside the orders for entry of his default which have been entered by the clerk of this court in the actions by Layman, Griggs and Yoshida. If those plaintiffs desire to oppose that motion, they should do so by January 16, 1989. The motion will be submitted on that date.

XI.

Plaintiffs have appealed from an order of United States Magistrate Joan Brennan granting the motion of Bryant to compel plaintiffs to respond to certain interrogatories and requests for production of documents. Because of this court's order granting summary judgment in favor of Bryant above, the court believes that the production of such information may now be moot. The order of the Magistrate of November 4, 1988, is therefore vacated, without prejudice to defendant Bryant again raising the issue before this court if he believes that such information is necessary for further proceedings in these cases.

Appendix F

XII.

All of the above cases are consolidated for trial, except:

a. *Central Bank v. McGonigle*, No. C-86-6453

b. *Spendthrift v. McGonigle*, No. C-88-0451

c. *Continental Casualty v. Bryant*, No. C-88-2577

d. The issue of "Time for a Change" in *Stratmore v. Combs*, No. C-86-0379

e. *Schultz v. Bateman Eichler*, No. C-88-3175

f. The cross-claims of Bryant regarding the plaintiffs' conduct of this litigation. Bryant has requested that this court's earlier ruling of severance be reconsidered. That request for reconsideration is denied.

XIII.

A pretrial conference will be held on January 26, 1989, at 2:00 P.M.

The trial will commence on February 27, 1989, at 9:00 A.M.

IT IS SO ORDERED.

Dated: December 22, 1988.

s/ Charles A. Legge
CHARLES A. LEGGE
UNITED STATES DISTRICT JUDGE

APPENDIX G — ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT DENYING PETITIONS FOR REHEARING FILED AUGUST 1, 1997

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 94-16391

D.C. No. CV-86-01692-CAL

GEORGE LAYMAN,

Plaintiff,

and

CALVIN KLEIN; BARRY K. SCHWARTZ, d/b/a BARRY K. SCHWARTZ PARTNERSHIP, a New York general partnership; EARL H. SHULTZ; KENNETH FRANZHEIM, II,

Plaintiffs-Appellees,

v.

ROGER SULLIVAN, as Executor of the Estate of FRANK L. BRYANT,

Defendant-Appellant.

No. 97-15340

D.C. No. CV-86-01692-CAL

BARRY K. SCHWARTZ, d/b/a BARRY K. SCHWARTZ PARTNERSHIP, a New York general partnership; CALVIN KLEIN; ZENYA YOSHIDA; KAZUKO YOSHIDA; ROBERT D. STRATMORE; KATSUMI YOSHIDA; EARL H. SHULTZ;

Appendix G

TERUYA YOSHIDA; KENNETH FRANZHEIM, II; HARUYA YOSHIDA,

Plaintiffs-Appellees,

and

GEORGE E. LAYMAN,

Plaintiff,

v.

ROGER SULLIVAN, as Executor of the Estate of FRANK L. BRYANT,

Defendant-Appellant.

ORDER

Before: CHOY, O'SCANNLAIN and LEAVY, Circuit Judges.

The court having duly considered the petition for rehearing filed in each of the two above-entitled cases, and the responses to those petitions, hereby DENIES each of the petitions for rehearing.

Costs on these appeals shall be borne by plaintiffs-appellees above-named.

APPENDIX H — RELEVANT STATUTE

15 U.S.C. § 77*l*

Section 12 of the 1933 Securities Act (15 USC section 77*l*)*

§ 77*l*. Civil liabilities arising in connection with prospectuses and communications

Any person who —

(1) offers or sells a security in violation of section 5 [15 USCS § 77e], or

(2) offers or sells a security (whether or not exempted by the provisions of section 3 [15 USCS § 77c], other than paragraph (2) of subsection (a) thereof), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable, subject to subsection (b), to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

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* As in effect during tendency of Petitioners' § 12 Claims (1986-88).